

DIARY

Book 152

November 20 - November 24, 1938

- A -

	Book	Page
Automobile Tires		
See Bids, Collusive or Tie		

- B -

Bank of America		
HMJr, Douglas, and Crowley confer concerning proposal to delist Transamerica securities - 11/23/38.....	152	406
Bids, Collusive or Tie		
Automobile Tires: Oliphant memorandum and results of action by Department of Justice - 11/23/38.....		422
Brazil		
See South America		
Business Conditions		
Haas memorandum on situation for week ending 11/19/38..		86

- C -

China		
Conversations at Changsha between British Ambassador and Chiang Kai-shek as reported by Captain McHugh, Assistant Naval Attaché - 11/20/38.....		1
Report from American Embassy, London, on report on British financial assistance for China - 11/20/38....		243
HMJr transmits to FDR (at Warm Springs) material used at conference with Chen and Chao (Director of National Railways) - 11/22/38.....		329
Civilian Conservation Corps		
Change in Uniforms: Peoples' progress report - 11/21/38..		242

- F -

Fiscal and Monetary Advisory Board		
Meeting; present: HMJr, Eccles, Bell, Ruml, Hanes, Taylor, Haas, White, Currie, and McReynolds - 11/21/38, 10:15 A.M.....		102
a) Memorandum: "Railroad Equipment - A Possible Bottleneck" - 11/21/38.....		158
b) Memorandum on existing expenditure programs financed without use of direct public debt or which might be so financed - 11/21/38.....		160
Meeting to consider possible Works Progress Administration lay-offs - 11/21/38, 4:15 P.M.....		164
a) Drafts of letter to FDR.....		181
Meeting - 11/22/38.....		276

- G -

	Book	Page
Germany		
Resume of revenues - 11/20/38.....	152	24
Discussion of total debt as reported by American Embassy, Berlin - 11/23/38.....		386
Great Britain		
See Stabilization		

- H -

Hungary		
Report by Royall Tyler acknowledged by HMJr - 11/23/38..		428

- J -

Japan		
Embassy asks that interview be arranged with Arakawa, Financial Commissioner at London, Paris, and Washington - 11/23/38.....		420

- L -

Latin America		
See South America		
Life Insurance Companies		
Harris-Hadley memorandum on cash position - 11/21/38.....		232

- P -

Peacetime Price Control Committee		
See Purchasing, Government		
Purchasing, Government		
Peacetime Price Control Committee; Peoples' memorandum on meeting held November 18th - 11/21/38.....		247
a) Peoples' memorandum on peacetime price control....		250
b) Chart showing organization; functional control of prices.....		255

- R -

Refugees		
Bowman sends copy of McBride report on opportunities for agricultural colonies in Central America - 11/21/38.....		18
Copy of Bowman's letter to FDR - 11/21/38.....		46
HMJr's letter to FDR concerning discussion with Bowman - 11/21/38.....		68
Buell (Foreign Policy Association) transmits copies of letters from staff member in Latin America - 11/21/38...		196
Outline of plan for refugee problem - 11/23/38.....		408
Ezekiel memorandum on refugee problem - 11/23/38.....		414

	Book	Page
Secret Service		
Report from Cole, Examiner of Questioned Documents, concerning three typewritten documents and whether they were prepared on same typewriter - 11/21/38....	152	241
South America		
Proposed letter (not sent) to FDR explaining view that rendering economic assistance to Latin American countries is one of two directions in which United States can effectuate foreign policy - 11/21/38.....		256
Brazil:		
Conference with regard to possibilities of financial agreement; present: HMJr, Taylor, White, Lochhead, and Penteado (Attache at Brazilian Embassy) - 11/22/38.....		269
Loans under consideration by Export-Import Bank.....		372
HMJr explains to Welles that United States Treasury will not enter conference of Secretaries of Treasuries of North and South America - 11/22/38.....		354
Speed, William		
Sulzberger asks HMJr's assistance; Speed involved as bank director of Louisville National Bank - 11/24/38..		403
Stabilization		
Great Britain:		
Conference before further talk with Bewley; present: HMJr, Taylor, White, and Lochhead - 11/22/38.....		361
a) Conference with Bewley regarding sterling exchange rate - 11/22/38.....		316
Memorandum from British Embassy to United States Treasury indicating views of His Majesty's Government in view of question raised by Sayre on exchange value of pound sterling (11/17/38).....		355,357,358

Tires, Automobile		
See Bids, Collusive or Tie		
Transamerica		
See Bank of America		
Tyler, Royall		
Report on Hungary acknowledged by HMJr - 11/23/38.....		428

	Book	Page
Unemployment Relief		
HMJr and Hopkins again confer on emergency - 11/21/38.....	152	36
a) HMJr wishes Hopkins to see draft of letter to FDR concerning "national emergency"		
Meetings of Fiscal and Monetary Committee to consider possible Works Progress Administration lay-offs - 11/21/38.....		102,164,276
a) Drafts of letter to FDR.....		181
Expenditures to date by Works Progress Administration and United States Housing Authority, and consequent situation of Works Progress Administration, discussed at 9:30 meeting - 11/22/38.....		262
Drafts of proposed letter from FDR to D. W. Bell re- apportioning Works Progress Administration funds because of "unforeseen extraordinary emergencies" - 11/22/38.....		323
a) Draft OK'd by Oliphant and Bell.....		324
b) Instructions to McKay for delivery - 11/22/38..		328
United States Housing Authority		
See Unemployment Relief		

Works Progress Administration  
    See Unemployment Relief

STRICTLY CONFIDENTIALTHE CONVERSATIONS AT CHANGSHA BETWEEN THE  
BRITISH AMBASSADOR AND CHIANG KAI-SHEK

1. The recent talks at Changsha on November 4th and 6th between the British Ambassador and Chiang Kai-shek were not, as had been generally rumored in the press, the medium for the former to convey to the latter peace terms from the Japanese. The shoe was, in fact, quite on the other foot. Chiang Kai-shek did most of the talking, as is indicated in the Aide Memoire of their first conversation, a verbatim copy of which is appended to this report.

2. Although I had felt that Chiang was still adamant on the question of continuing resistance and knew in advance that Sir Archibald's visit was the result of an invitation which the Generalissimo had extended to him during the course of their last meeting at Hankow late in July, I myself was led to believe by the persistent reports coming over the radio news broadcasts just prior to his arrival at Changsha that he might be the purveyor of terms. It was obvious that if Japan could not arrange terms after the almost simultaneous capture of Hankow and Canton, there were no key points or centers in the field ahead of them the capture of which could be used either to bring pressure on the Chinese or which could be publicized in Japan as the "final victory" of the war. I was led to the further suspicion of possible peace efforts by the Ambassador, as his entourage approached Changsha from Kuning, by secretive hints from my friend, the Commanding Officer of HMS "Sandpiper", that he had received very important despatches for H.E. which contained amazingly easy peace proposals. I gathered that either the British Embassy in Shanghai or Tokyo was forwarding these, the general nature of which included a ninety nine year lease on Manchoukuo, demilitarization of China north of the Yellow River, complete withdrawal of Japanese troops to the coast (with certain conditions) and agreement to negotiate with the Kuomintang conditional upon certain changes in personnel and policy.

3. I later discussed these points with Sir Archibald direct. He laughed and said they were what his friend Mr. Tani (the Japanese Minister at Large in Shanghai) had frequently spoken to him about. When he had asked Mr. Tani, however, if he might discuss these terms with the Generalissimo and present them as a formal proposal, Mr. Tani had beaten a hasty retreat, saying they were only his own ideas and not officially approved. (obviously lacking the Army's concurrence)

4. The British Ambassador arrived at Changsha on the evening of November 3rd accompanied only by a young private secretary and his new Military Attache, Lt. Col. C. N. Spear. At the invitation of the Captain of HMS "Sandpiper", I was among those who met him. Mr. Donald had arrived that afternoon from Nan Yueh (Heng Shan), where the Generalissimo was staying, to arrange the talks. The Generalissimo and Madame Chiang came up the same night and went to the private villa of the Governor of Hunan on the outskirts of the city. Chiang Kai-shek had just returned from a trip to Nanchang by car where he had gone for a military conference. (He and his party had flown from Hankow to Hengyang when they evacuated on the night of October 24th and he went to Nanchang soon afterwards.) Sir Archibald expressed pleasure at seeing me when he arrived and immediately inquired in Mr. Donald's presence if we might have a chat while he was there. Mr. Donald had arranged for him to lunch with the Generalissimo on the following day, November 4th, and to have his first talk with the Generalissimo in the course of the afternoon. Sir Archibald thereupon suggested that I come the day following.

5. I met Mr. Donald the next morning while he was waiting to escort the Ambassador to lunch. He discussed in general the failure of the British to live up to their commitments as a member of the League of Nations and help China; their silence over the capture of Canton and the portents of that action to Hongkong; and asserted that it was idle to criticize the Chinese methods of fighting the war. He said they were doing it their own way because they are Chinese, but that what England and the U.S.A. had to decide was whether they wished to see China go under and with that event lose their prestige and potential trade in China, or preserve these by helping China now. He was convinced that if Great Britain did nothing about Canton, her silent acquiescence would have serious repercussions on her prestige elsewhere, especially in India.

6. I saw Sir Archibald the following noon, November 5th, just before lunch, but any opportunity to speak with him privately about his talk the day before was forestalled by the entry of Lt. Col. Spear and the host. He therefore only remarked in general about what had transpired saying that Chiang Kai-shek had asked him some very embarrassing questions as to what London was going to do about Canton. Air raid alarms prevented me from seeing Mr. Donald this date, the foreign residences being on an island in the river and the Chinese soldiers along the banks having the disagreeable habit of taking pot shots at anything which moved during an air alarm. (If one could have been sure they were aiming at him, it would not have mattered, but the danger lay in the stray shots.)

7. I met Mr. Donald the following morning, November 5th, by crossing the river before breakfast to beat the alarms. He remarked, however, that my inability to cross on the previous day had not mattered as he had been busy all morning writing the Aide Memoire of the conversations between the Ambassador and the Generalissimo of the day before. He asked if I had seen the Ambassador and if he had told me about his talk. When I replied that the Ambassador had mentioned the general tone of his talk, but had been precluded by other guests from discussing it, Mr. Donald dilated a bit on the fact that the Generalissimo had bluntly asked London what they were going to do. Mr. Donald discoursed again on the possible results to British trade and influence if they failed to act and then advised me to see Sir Archibald again and ascertain if he would give me the full details of the Aide Memoire. He characterized it as a very important document which he felt Washington should also see, but said he did not feel free to reveal it without permission as my Ambassador would naturally resent any such liberty if he were similarly placed. I informed him that I was to have lunch that noon with the Ambassador and would endeavor to obtain a chat with him later when I felt reasonably sure he would grant the necessary permission.

8. Mr. Donald then informed me that if the democracies fail China at this time, she obviously would have to turn elsewhere and that the question of her policy for the coming year would be the chief point on the agenda at the forthcoming meeting of the Central Executive Committee of the Kuomintang which would take place in Chungking early in December. I inquired if there were any chance of a turn toward Russia and asked if during the intervening period after we had left Hankow at the beginning of August until our return just before the fall of the city the Russians had presented any quid pro quo to the Generalissimo in return for increased aid from them. (Both Mr. Donald and Madame Chiang had repeatedly denied to me in the past that this had ever occurred, saying that China had paid for all of the help she had received from Moscow.) He replied that the Russians now had something over one hundred planes at Lanchow and that they had approached the Generalissimo shortly before the decision was made to leave Hankow with the proposal that

they would make not only those, but as many more available to him if he would agree to continue resistance against Japan. Chiang had snorted and replied that he intended to continue resistance whether they helped or not. (It seems pertinent to remark here, as I have stated previously, that Chiang Kai-shek has been consistent from the very beginning in this respect and in his policy to carry on the war to a finish. He has taken the point of view that his cause is just one and that sister democracies could not fail ultimately to come to China's assistance. He has spurned all suggestions of help with conditions attached - viz: the British suggestion last Spring that he remove Dr. Kung.)

9. Mr. Donald then stated that if China turned away from the democracies he thought it would be toward Germany and the totalitarian states; that they had already given far more material aid to China through their barter agreement and military advisors than any other country and that the barter system not only had great potentiality in the post-war reconstruction of China, especially since China would have no money, but that the Germans had proved themselves peculiarly adept at doing business with the Chinese. I inquired how this could be reconciled with the Berlin-Tokyo agreement and where China would stand vis-a-vis Japan in such an event. He then revealed one of the most important points in the Aide Memoire, namely, that the Generalissimo had always known and now had especially good reason to believe that he could get very easy peace terms from Japan anytime he would agree to the exclusion of the British from China. He said he had already advised Chiang, however, that if it came to that point, he should make terms through Berlin rather than directly with Japan. He reiterated his belief that a German-Japanese economic alliance would have a genuine chance of success in developing China after the war. (I had already discussed with Mr. Rogers in Hongkong sometime ago the possibilities of an extension of the German barter system on a grand scale to China, but from the point of view of weaning Germany away from Japan and effecting some kind of understanding with England, France and other states. He had expressed serious concern over the potentiality of this weapon of Hitler's, saying that he was intimately acquainted with Dr. Schacht and respected his ability. It is a question worthy of serious thought, particularly if it includes Japan and excludes the rest of us.

10. I then went to lunch with the British Ambassador and immediately afterward asked if I might have a word alone. He readily assented and took me to his bedroom where he walked up and down and talked without restraint for over an hour. I recorded the following memorandum of this conversation immediately afterward:-

11. I opened the conversation by recalling to him what he had told me the day before of Chiang Kai-shek having faced him with the fait accompli of Canton; mentioned a conversation I had had with Rogers over the possibility of weaning Germany away from Japan in some sort of joint economic agreement with other nations; of the latent possibilities in the barter system; of the belief held by Donald and Captain Steppes that Germany might assist Japan in China by this means; and inquired what he thought of the possibility of China turning away from the democracies completely and reaching an understanding with the totalitarian states.

12. Sir Archibald said that he too had been giving serious thought to this question. He said he had just been engaged all morning in preparing a draft message to London. He said that in his conversation the day previous with Chiang Kai-shek, he had asked Chiang frankly for a statement of his military position and his possibilities for continuing resistance, telling Chiang it was much more desirable to get it from him direct than to have to guess at it. The Generalissimo replied that he now had sixty divisions



north of the river, sixty south thereof and a like number in reserves. (The Ambassador asked me what strength these would represent and seemed surprised when I told him that they averaged five to eight thousand effectives before going into the line and the figures given undoubtedly included many units which by now were mere skeletons.) Chiang had stated that these would soon be reorganized for active guerrilla warfare and that his policy would be to present to the Japanese a constant threat of attack while continuing general resistance, always giving way where necessary to avoid too severe losses and ultimately to choose his own ground for battle. The Generalissimo had said he had supplies for more than a year yet at the 'present state of wastage' and expected to continue his program of resistance unabated.

13. The Ambassador said that Chiang had spoken with great frankness and with considerable agitation on his position vis-a-vis Great Britain. He stated that he had held China together all these months on the plea that aid would be forthcoming eventually from the democratic countries, notably Great Britain, and bluntly asked for a showdown and a simple "Yes" or "No" on the question. He put it up to the Ambassador that if China were not going to obtain aid from Great Britain and the U.S.A she obviously would be faced with turning elsewhere and asked Clark-Kerr what he would do if he were similarly placed. The Ambassador told me he obviously had to agree.

14. Sir Archibald said he had then asked Madame Chiang, who was translating, if the Generalissimo would not come out frankly with what was in his heart. Madame Chiang inquired if he really wanted the truth and the Ambassador replied that they would be much better off to have it out then and there. Chiang Kai-shek became visibly excited at the question and said that Great Britain might as well understand that they were at the parting of the ways. If Great Britain chose to help China, she would have China forever; if she rejected this final appeal then China would turn completely away from Great Britain and never have anything more to do with her; that he himself would never consult Clark Kerr on a single question. The Generalissimo added that the Chinese have long memories and that if Great Britain forsook China at this time, they would never forget it and would make them pay for it ultimately.

15. The Ambassador said that the problem was a very serious one and that he was at a loss as to how best to cope with it. He recalled to me his previous efforts at obtaining a loan for China to support the currency and said he had gotten his Foreign Office completely with him on the question, but had been unable to get the Treasury where he had been blocked by Sir John Simon. He remarked that I no doubt knew the latter's attitude toward Japan. He said that Sir John lived in absolute fear of Japan and was constantly encouraged in this by his colleague in Tokyo (Sir Robert Craigie) who constantly sent home despatches about the power of Japan. Sir Archibald said that he and Craigie differed absolutely on the question of the effect of the present war upon Japan; that he felt the war was a tremendous strain on Japan which sooner or later must produce a general breakdown (he said he felt this might come within another six to eight months time) while Craigie kept insisting that Japan was in no such danger and had not yet felt the strain of the war to any extent. Clark Kerr said that he thought our representatives in Japan lived too cloistered an existence to know the true state of affairs there.

16. Sir Archibald remarked that the loan involved was a relatively small amount and that he was now engaged in drafting a despatch to try and re-open the question. He said that Chiang Kai-shek had mentioned the fact that if Great Britain could only give him something tangible to show the country such as a loan to support the currency he could satisfy them. Clark Kerr was not sanguine as to the prospects of a loan, however. He remarked that T. V. Soong had told him during a recent conversation in Hongkong

that China was endeavoring to establish a stabilization fund of six million pounds sterling to which the Chinese banks would contribute half and had asked if the British banks would contribute the balance. (Rogers conceived this idea in Hongkong in September while I was there.) The Ambassador said that he had first approached the Hongkong and Shanghai Banking Corporation who, while favorably inclined, had refused because there was no ample security for their depositors and bondholders. He had then referred the matter to the Bank of England from whom he had not yet gotten an answer. He remarked that he had quite understood the Hongkong and Shanghai Bank's position, but that the Bank of England could afford to be sentimental and take a chance occasionally as they had done in Austria in 1922 where they had gotten away with it. He stated that he had proposed the original loan to China as the first step of a long-view policy with the second step to be taken next year if the situation were still favorable; that if it proved otherwise it would always be possible to step aside and that the loan itself would always be amply justified as an investment in good-will.

17. The Ambassador then told me the following in strict confidence. He said that last July while he was having dinner one night with the Chiang Kai-sheks along with Hall Patch and others of his Mission, Madame asked him to step outside and speak to the Generalissimo alone for a minute. She warned him to listen carefully to what the Generalissimo said as he had rehearsed it and that she had never before known him to make such a statement to a foreigner.

18. Chiang Kai-shek had commenced (speaking in short sentences, whereas he usually is hard to interpret because of his length) by saying that he had known several British Ambassadors. He spoke well of Lampson, whom he had liked. Cadogan he had also liked although he found him less sympathetic and lacking in imagination. Knatchbull-Hugesson he had not cared for so much. But he, Clark Kerr, the Generalissimo had found by far the most understanding of them all. Chiang Kai-shek therefore desired to know if Clark Kerr would be willing at times to put aside his official rank and advise him on matters as he might request. Clark Kerr said he himself uttered a lot of deprecatory sputtering during this effusive outburst by the Generalissimo and assured him he would be most glad to comply with the request. As they walked out Madame Chiang again impressed upon him how absolutely unique and unusual this action had been on the part of her husband.

19. A few days later the Generalissimo invited him to call and, referring to this incident, said he would like to make his first request. He thereupon asked Clark Kerr if the latter thought the Chinese Government needed reorganizing and, if so, what would he suggest. The Ambassador said he turned to Madame Chiang and asked if he really could reply frankly. She urged him to do so. He then told Chiang Kai-shek that he thought reorganization very seriously needed. He said if he were Chiang Kai-shek his first move would be to call all members of the family to Hankow, included Madame Sun Yat-sen, and to bring the Young Marshal out of retirement. He would then line them up and present a solid front to the Japanese ('have all of them tweak their noses at the Japanese', as he expressed it). He said he thought this would have a drastic result in Japan. He recommended that Dr. Kung be retained as President of the Executive Yuan (remarking aside to me that he did this to save Kung's face, but placed him where he could do no harm). He suggested that Madame Sun be made Minister of Cooperatives or something similar (telling me he purposely included her to take care of the Communist element) and strongly recommended Madame Chiang as Minister of Foreign Affairs. (Although

the foregoing sounds semi-jocular, he related it in all seriousness.)

20. He then went on to recommend to the Generalissimo that he reorganize the entire Government along the lines of the membership of the People's Political Convention (which he said he thought had been very well chosen) and that he pointed out to Chiang Kaishek the need for placing men according to ability and qualification rather than giving all of the plums to former comrades and old cronies. The Ambassador said his suggestions met with a chilly response and obviously did not meet with the approval of the Generalissimo who remarked that if Madame Sun came to Hankow she would only be a mouthpiece for the Communists. The Ambassador said he had talked with Madame Sun in Hongkong; that he liked her best of the whole family; and that she had expressed her desire to go to Hankow if the Generalissimo would only invite her.

21. The Ambassador promised to show me the despatch he was drafting to the Foreign office concerning the Aide Memoire and readily assented to my request to be permitted to read the Aide Memoire. His copy was at the moment out on the gunboat. He asked me to return in a day or two to see the despatch, remarking that he actually had no business doing this. He said he had recently proposed that the British, French and U. S. Governments should make separate but as nearly identical as possible declarations affirming their support of China. The French, he stated, had indicated their willingness to do so, but the proposal was frowned on and killed by the U.S.A. He inquired who our present counsellor of Embassy in London was and said he understood this officer had been instrumental in it. The Ambassador termed the attitude of his own government toward the recent situation "contemptible". He said he understood the general limitations which restrained the U.S.A. from taking direct action, but inquired if I knew whether this were further constricted or aggravated by any particular individuals in Washington. I denied any such knowledge. The Ambassador and his party had dinner with the Generalissimo that same evening, but as the party was fairly large, nothing further transpired.

22. The following morning, November 7th, I met Mr. Donald as he was going for a talk with the Ambassador. When I told him I had received permission to see the Aide Memoire, he pulled his copy out of his pocket and loaned it to me while he went to keep his engagement. He likewise conveyed to me an invitation from Madame Chiang to come to lunch the following day. I returned to my quarters at once and made the attached copy of the Aide Memoire.

23. Lunch the next day was a simple family affair served on a card table with only Mr. Donald in addition to the Chiangs. Madame Chiang told me before lunch that the Generalissimo had been told that I was acquainted with what he had said to the British Ambassador. The Generalissimo appeared looking quite fresh and showing no signs of the strain he had exhibited during the latter days at Hankow. I have seen him numerous times in the past so there were no formalities between us.

24. I let him open the conversation and he started by asking me when the new U. S. battleships would be completed and if they would be larger and more numerous than those being built by Japan. He appeared slightly surprised and disappointed when I told him they probably would not be launched until 1942 or 1943. (I had to guess at this as I have been out off from the news a good deal

recently, but did not want to give him any encouragement on this score.) I told him I did not know what Japan's building program is, but that I doubted if they could afford to compete with us. He then asked how much longer President Roosevelt had to serve and seemed to brighten when I told him two years. He asked if the President could be re-elected and nodded pleasantly when I told him there was no legal bar to this. He inquired if I thought public opinion against Japan was growing in the U.S.A. and nodded understandingly when I told him that I thought it was, but added that its development was gradual and that the American public naturally were more interested in their own affairs and were primarily desirous of peace.

25. I then repeated briefly what Clark Kerr had told me of the Generalissimo's military program and inquired if this were essentially correct. He agreed except to amend the part about sixty divisions north of the river and sixty more south thereof. He said that was roughly the present distribution, but that he proposed to use sixty east of the two railway lines, sixty to the west thereof and the balance in reserve under reorganization. He explained that a great many of these divisions had been in the field for several months and that some were now reduced to the strength of only one company. These had to be pulled out for rest and reorganization while others had to be brought up. Other than the mention of the railway lines, he did not mention a front as such, but merely asserted that he intended to keep the Japanese under the constant threat of attack in all areas. He spoke of the guerrilla tactics which had been carried out all of these months and said the Chinese would depend on these rather than sacrifice their strength in trying to hold any particular point. He appeared to me to be very confident in this respect and I believe he is imbued with the experience he had in fighting the Communists for years.

26. I had expected the Generalissimo to ask me questions about what we were going to do to help him and when he failed to do so, I referred to what he had said to the British Ambassador and inquired if I were to infer that this applied with equal force to the U.S.A. He was called away from the table just as I finished putting the question, but as he rose to leave he replied that he thought that had better wait until he could discuss it directly with my Ambassador.

27. I walked for an hour after lunch in the garden with Madame Chiang and Mr. Donald. I asked Madame CHIANG for an explanation of the Canton debacle which would explain or refute the assumption of the general public that there had been a "sell-out". She denied vigorously that there had been any bribery. She referred me to the Generalissimo's public statement of October 30th and added that Yu Han-mou had failed to make the proper disposition of his troops because his staff officers and troop leaders were inferior. She mentioned that a statement in regard to this had been included in the Generalissimo's public announcement, but Mr. Donald interrupted to say that "we" (presumably he and Hollington Tong) had cut out that part. She then went on to say that this plus the fact that the British had failed to intervene had produced the present situation, but added that they were now fighting to recover the lost ground and said the Generalissimo had had a telegram just the previous evening that Samshui had been re-captured. She denied that the Japanese had made any progress along the railway north of Canton. She stated that the Generalissimo was receiving hundreds of telegrams from overseas Chinese demanding that China continue to resist Japan and calling for the punishment of Yu Han-mou and Wu Teh-chen. She did not, however, enlarge on the latter point.

28. I asked point-blank how the Generalissimo could adopt the alternative he had mentioned to the British Ambassador of making easy terms with Japan if he would completely renounce the British. I pointed to the widespread feeling against Japan and the fact that the Japanese army exists as a physical enemy and invader. She did not blink an eye, but replied simply that she thought the people would do whatever the Generalissimo told them was best when the time came. I then referred to the 1924-1930 era when the anti-foreign feeling was so high; contrasted it with recent months when the people had been so friendly to foreigners; and asked if officials would take the lead in turning the people against Great Britain in order to make possible a peace treaty with Japan. I added that the comparison of the two periods had led me to believe that public opinion in China could be influenced very easily by officials. She dodged the question by saying that she and the Generalissimo had worked very hard for a long time to bring about a friendly feeling toward foreigners. I asked again about the questions which had been presented to the British Ambassador and inquired if they did not apply with equal force to the U.S.A. She reiterated that any actual statement on the question should await a meeting between the Generalissimo and my Ambassador, but said that we "might well consider the questions asked Great Britain as the handwriting on the wall".

29. I saw the British Ambassador again that afternoon for another long talk. He asked if I had seen the Aide Memoire. When I told him I had, he stated he had radioed all of it to London except the reference to Hainan Island which he thought was superfluous and weakened the argument. He said he did not desire to give London any point on which to quibble. He apologized for not being able to show me his despatch which he said had just gone to the ship to be coded, but told me it followed the lines of what we had discussed the previous time. He handed me from his table another despatch which he had just drafted in which he had outlined briefly the Generalissimo's general attitude and determination to continue resistance.

30. When I referred to the points in the Aide Memoire as an "Ultimatum" he picked me up immediately. He emphasized that there had been no questions of an ultimatum on the part of Chiang Kai-shek during their conversation and that he himself, after reading the Aide Memoire, had sent a second telegram to London to emphasize this. He said that Chiang had put the questions simply as statements of fact to which he desired an immediate answer; that Chiang had stated that he had always desired friendly relations with Great Britain and up to the present had been confident that Great Britain would help China, but that the time had arrived when he had to have something tangible to show the people, if it were only a loan to support the currency. When Chiang had stated that he had 'several other courses open' if London failed him, the Ambassador had asked if Russia were one of these. Chiang had silently assented, but had offered no further information on this point. Sir Archibald seemed surprised when I told him that both Madame Chiang and Donald had specifically denied on several occasions that the Russians had ever presented a quid pro quo to the Generalissimo. I mentioned the recent case of the planes at Lanchow and he said that Donald had also told him that.

31. The Ambassador said that he was at a loss to understand his country's attitude; that he could not understand why they fear Japan, especially now when Japan is obviously too weakened even to think of fighting any other country. He said that prior to assuming this post he had asked in the Foreign Office if they could give him any directive as to the policy they wished to pursue out here. He was told that he would have to work it out largely for himself, but that in general they thought the Chinese and Japanese should fight it out among themselves. He again referred to their present position as "contemptible" and said frankly he did

not know how to solve the problem.

32. I had made plans to leave Changaha at once and get to Chungking as soon as possible with my information. The Ambassador had already persuaded the Chinese to send him on to the coast via Nanchang to Foochow. I accompanied him from the above interview to the gunboat where he was greeted with a message from his representative in Chungking urging him to come here to avoid offending the government officials. The Ambassador changed his plans on the spot and, turning to me, inquired if I would like to join his caravan. I accepted because it afforded me an opportunity for further conversation and likewise provided company through the bandit region of eastern Kweichow which people had been advising me to avoid.

33. When I went to the local airport to see him off as he left by private plane for Hongkong on the afternoon of November 19th, he told me he had been receiving urgent messages from Sir Robert Craigie asking for permission to show the Aide Memoire to his American colleague. He said Sir Robert also had recently changed his tune very decidedly with regard to Japan and that he hoped to draft a message on the plane enroute to Hongkong to get off to London from there and take advantage of this change of heart while it lasted.

34. Mr. Donald informed me just before I left Changaha that they had decided to cable the Aide Memoire to Dr. Hu Shih in Washington, but that they had added an injunction that he was not to show it to anyone until he received permission. Mr. Donald said they had done this to permit me to reach Chungking with it first.

35. I have presented the foregoing in rather exhaustive detail with a double purpose, (1) I desired to give as accurate as possible an account of what actually transpired and was said in order that it could be evaluated in its true perspective, and (2) to bring out my belief that the information was not "cooked up" or "planted" on me by either the British or Chinese. I merely happened to be on the spot when the talks took place and to have had the advantage of prior intimacy with both parties plus an informal status which permitted them to talk freely to me.

#### 36. Conclusions

After my arrival in Chungking with the foregoing information our Ambassador requested that I submit to him a Memorandum containing my reactions and opinions concerning the present situation in the light of what I had experienced at Changaha. I append hereto as Enclosure "A" a copy of this memorandum as my conclusions to this report.

OFFICE OF THE NAVAL ATTACHE  
AMERICAN EMBASSY  
CHUNGKING

24 November, 1938.

MEMORANDUM FOR THE AMBASSADOR

Subject: The Conference at Changsha Between the Generalissimo and the British Ambassador and the Interest of the United States in the Situation Resulting Therefrom.

1. Upon first reading the Aide Memoire and talking with Mr. Donald and Madame Chiang thereafter, I gained the impression that Chiang Kai-shek had presented the British with an ultimatum and I so referred to it, as noted in my report, in my second conversation with Sir Archibald. The document contains both the time element in its request for an immediate "Yes" or "No" reply from London and what on first glance appears to be an implied threat in its assertion of there being alternative courses of action if the British fail. In the light of the British Ambassador's subsequent explanation and of further consideration of the situation, however, I believe that Chiang Kai-shek merely confronted the British with a cold assertion of fact and the simple statement that if they do not come to China's aid, China must perforce seek assistance elsewhere.

2. The situation is unquestionably very serious and must be so dealt with. It presents a difficult problem and certainly one not to be brushed aside with a light wave of the hand or a vague hope that 'all will come out all right in the end'. It is true that at the moment we are not as much "on the spot" as the British, for we are not a member of the League of Nations, we have made tangible efforts at granting some kind of financial assistance to China through the purchase of their silver and the recent negotiations with the F. P. Chen Mission, and our note to Japan of October 6th has been very favorably received by the Chinese. The British are committed to specific courses of action which they are not implementing; they have hinted at loans they are not producing; and they are maintaining a strange silence toward the preempting by Japan of large commercial interests through which they once dominated the trade of the Far East. More than this, they have actually negotiated with the Japanese on at least two occasions; the Customs Agreement and the British American (Yee Tsoong) tobacco interests.

3. But in the sense that we are the leading democracy of the world and stand for announced principles which have been contravened right and left ever since the invasion of Manchuria in 1931; that it has been possible for Japan to obtain important war materials from us; that we have a large cultural stake in China which is in danger of being swept away, we too are "on the spot". It is my firm belief, therefore, that if China turns against Great Britain, we shall ultimately share the same fate unless we produce more tangible assistance to China, and do it in the near future.

4. The problem of the moment can be stated very simply: China is fighting for her life, for her independence as a nation. Japan has declared her purpose on more than one occasion of dominating not only China, but the whole of the Far East; of creating an "Asia for the Asiatics".

5. What do we want, China or Japan?

6. The situation of the moment, as I see it, is as follows: China has been fighting a losing battle for sixteen months, confident that sooner or later the democracies must come to her assistance. The failure of the British even to make a statement, much less take any action when Japan occupied Canton and cut off Hong-Kong, came as a cruel blow and rude awakening to the Chinese. They have therefore asked the British, 'Are you going to help us or not? Are you even going to stand up for your own interests? If not, we must know it now and adopt some other policy.' China has now reached the point where she is almost completely cut off from supplies and has only enough remaining to carry on the fight a few months longer. She cannot wait until the moment of total exhaustion comes to make her decision.

7. Our problem has to be analyzed from the two angles as stated, Do we want a strong, stable, peaceful and independent China, or do we want an Asia dominated by Japan?

8. The Japanese program is clearly one of driving us and our institutions out of Asia. Any attempt to minimize this, to regard it as temporary, to apologize for it, to seek hope in the fact that a portion of the Japanese people may have been unsympathetic with this war or to argue that our trade with Japan has been far more valuable to us than our trade with China is short-sighted and evasive to say the least. Let the ultimate goal of the Japanese be clearly understood from the first, for it is cold and simple fact, regardless of what friends of Japan may argue.

9. That the Japanese army may utilize the aid of the Germans or other totalitarian states for a time during the process of achieving this domination constitutes no saving clause for us. Any benefit which either we or the British may derive through the Japanese in the post-war economic rehabilitation period of the present conflict, even if they emerge only semi-victorious, will be temporary exactly in proportion to the degree of their victory and the period of time it takes them to reach the point where they feel strong enough to kick us out. Any attempt to assume greater hope than this is totally unwarranted in the face of what has already transpired. They are arrogant, truculent and their promises to us are wholly unreliable. No statement that they make to us is worth the paper upon which it is written or the breath required to utter it unless it be one of those not infrequent occasions when they let slip their real purpose. Anyone who may think his future is safe in their hands is taking a very long chance.

10. The extent of the victory which they may achieve from their present venture is problematical. I have felt from the outset of this war, as I have stated in previous reports, that they were walking into a swamp; that there are not enough Japanese in Japan to patrol and police this vast country with its millions of people; and that eventually the Chinese will suffocate them or rise and massacre them as they did the Manchus after 250 years under their rule. But the long point of view offers little solace and no solution to our own immediate problem.



-3-

11. It has recently been suggested by a competent authority on Japan that the Japanese do not intend to attempt the "pacification" of all China; that they propose to sit down on what they have, open and maintain the lines of communication, establish trading outposts as one would do in darkest Africa; and let the Chinese "stew in their own juice" back in the interior. It is this lesser goal, with the possibilities presented if the Japanese obtain the cooperation of the Germans and their barter system, which gives food for thought and is a problem worthy of serious consideration. What its possibilities are we do not know. But what we do know is that it will exclude us and slam our "Open Door" in our face.

12. Let it not be forgotten also that the present attempt at conquest on the mainland of Asia is the Japanese Army program and that the Japanese Navy still has to be heard from. They have had very little part in this war to date. The Navy program has long been known to advocate expansion toward the South Seas. China is, in reality, a great big farm and does not possess anything like the wealth of undeveloped resources that many writers have claimed. But to the south lie the Malay Peninsula and the Dutch East Indies with their known wealth of rubber, tin, oil and other resources. Will Japan ignore these if she succeeds in China?

13. In our present efforts to establish reciprocal trade agreements with free nations throughout the world, which may lead eventually to unrestricted trade among democratic nations, we have our most potent weapon for an ultimate solution. But again this is not a solution for the present crisis. Should we, can we sit idly by and watch the world's next biggest democracy and one of the most potential areas for the extension of this policy co-opted and stifled by Japan and her allies and closed to our commerce simply because that nation is still too cumbersome and lacking in munitions and supplies to take care of itself?

14. Thus far we have given the Chinese almost nothing but moral support in this war while affording the Japanese the materials for war. That we have done this latter not intentionally but merely in pursuance of our own "open door" policy to any purchaser who has the money with which to buy is not a satisfactory reason considering the result it is producing for us in Asia and the prospects for the door which we hope to keep open there.

15. The second angle of the problem is the Chinese side. In my questions to Madame Chiang I indicated my apprehension that the Chinese might be aroused against us by inflammatory speeches in order to pave the way for peace with Japan. But it has since been suggested to me, and it is very plausible, that if we continue our policy of non-interference and fail to supply them with tangible evidence of our good will, they may automatically turn against us. There is no reason why they shouldn't. They are a nation fighting for their life and, as the British have been told, if the democracies do not help them, they naturally must turn to those who will.

16. As I stated in a recent despatch, I believe this feeling would easily arise and would be very difficult to combat. I lived in China during the period of intense anti-foreign feeling from 1924 onward, when whole cities burst into flames of hatred overnight and illiterate coolies mouthed slogans against the foreigner; when every Chinese eye had a baleful glint in it as a foreigner passed; and when laborers, dock workers, factory employees and servants staged "go-slow" strikes, "sit-down" strikes and outright strikes accompanied by the most fantastic demands long before the C.I.O. ever thought of these devices.

17. I have been very favorably impressed during recent years, and especially during the one just passed, with the generally friendly attitude displayed toward us. It is true that since the outbreak of the present war foreigners living in China have been on common ground with the Chinese in hating the Japanese and that this has greatly enhanced the feeling of friendliness on the part of the Chinese toward foreigners. But I have been apprehensive for a long time that the day might come when they might turn up with the cry that we had failed them, for the Chinese are past masters in the art of alibi and will never accept the blame for the loss of the war themselves. Individually they have never wanted the war from its very beginning. They are a peace-loving people and they have constantly hoped that someone else would come along and fight it for them. Had this third party appeared, they would have tossed him the baby forthwith and let him carry it. The Chinese aviators have already demonstrated this on several occasions, both with the Russians and the "Foreign Legion" 14th Squadron. But the Chinese had to fight this war alone in order to achieve any degree of unity and they have already derived immeasurable benefit from it in this respect.

18. I remarked in my report No. 1-38 last January that I thought an ideal result for this war would be for it to go on long enough to burn the corruption and venality out of Chinese official life and at the same time to break the hold of the Japanese army on the national life of Japan. That the Chinese and Japanese should fight it out between themselves has unquestionably been the point of view of many people and this has been correct up to a point. But as one who has been in the thick of the war almost from its beginning and who has travelled rather extensively through the country in recent months, it is my considered opinion that we have reached the point where we no longer can leave the outcome to chance. Some people may sit back and say complacently that the Chinese will never be able to do without the U.S.A. either economically or politically, but personally I am not so sure.

19. Furthermore I believe that if feeling starts against us it can be fanned into flames very quickly by "soap box" orators and radio broadcasters on the charge that we let them down. The cry may start against the British who are far more culpable and vulnerable than we for we made no promises and we are not a League Member. Our position and our reasons for not helping have been perfectly clear to us; they have been nothing like that clear to the Chinese. And if a hue and cry should start against the British, there would be little differentiating done by the Chinese masses between British and Americans. It may be said that the British were specific targets in Shanghai, Canton and Hongkong in 1925 and 1926 and that we did not suffer as much in comparison, but those were specific areas where the target could be identified. Such was not the case in other parts of China, as residents of Changsha, for example, will testify, and such will not be the case this time if it comes.

20. I have emphasized the potential turn of feeling against us to bring out one point: that irrespective of the outcome of this war, the recent conferences at Changsha impressed me particularly with one fact -- namely that we are faced with the immediate question of retaining China's good will. Whether the war ends in a stalemate with neither side winning, or Japan wins, or China compromises with Japan, we have this question to answer now. We have 154 years of cultural effort behind us in China. Almost every other member of the present government is American educated. But our pupils are the ones who will be most disappointed, and in many

CABER disillusioned, if we fail them now.

21. The main question, however, still is: Do we want a strong and independent China, or one dominated by Japan? The immediate problem is, Will we act to preserve China's good will while we still retain it? The answer to the latter will largely constitute the answer to the former. It hardly needs saying that if Japan achieves any marked degree of success in this venture, we shall have to build a navy several times as large as the one we now contemplate. The best insurance we can obtain for peace and for the further development of our trade program is a strong, independent, peaceful and friendly China together with a chastened, not a ruined Japan. The only hope of achieving that, I believe, is to retain the good will of the Chinese before it is too late.

22. The present Government of China, despite its many shortcomings, is the only one in recent years that has ever done anything for the people. It has represented that which we regard as rational and that with which we have some chance of doing business along the lines we desire and in accordance with the principles for which we stand. It was achieving steady progress in the development of China before this war commenced. There is bound to be chaos and disorder for a time after this war, whoever wins. Let there be no mistake about that. But the support of Chiang Kai-shek and his government offers by far the most hope for a solution of this chaos and a return to normalcy in the minimum possible time.

23. It is not a question of the Kuomintang versus the Eighth Route Army and which set of principles should guide the government of China. That is something for the Chinese to work out for themselves after the Japanese have been pulled off of their backs. In that respect our interest again lies in maintaining the friendship of the Chinese and in influencing them thereby to adopt orderly processes of government in harmony with those for which we stand. It need only be remarked in passing that the so-called Communist Party continue to support the Central Government with apparent sincerity; that they have again refrained at the recent People's Political Convention from endorsing any resolution critical of the Government; that they still profess unbending opposition to Japan (which is probably the best assurance available to any who may fear a sudden Chinese compromise with Japan); and that they show signs of developing into a democratic or popular party rather than communists as we think of the term. If this trend continues, they will provide China after the war with the healthy political opposition which any democracy needs and thereby force the elimination of the undesirable and corrupt elements in the Kuomintang.

24. There are many people in the U.S.A., and among them some officials, who appear to think that there is no ground between war and full retreat. It has been my conviction for a long time that there is a very wide stretch in there and that in it lies the means to peace through firmness and dignity. We have got to do more than voice our principles and write notes about them. We have got to insist step by step that they be recognized and respected. In a world which is relying on force we cannot possibly hope to survive by lip service to altruism. We must utilize our tremendous potentiality, both economically and financially in support of the principles for which we stand.

25. Nor can this be accomplished through a policy of indirection. It must be a studied program in which pressure is applied step by step with the will to fight if necessary as the last move. This is the point that our people must come to realize -- that we cannot run away from war or leave it until some vague future date when we might be invaded. When the time arrives, if it ever does, that any foreign power or combination thereof feels strong enough to attempt to invade the U.S.A., it will probably be too late for us to resist effectively. But the United States can be invaded in more ways than by an army. The influx of cheap Japanese products in recent years and its harmful effect on our labor situation was a case in point.

26. I have watched the Japanese ever since they invaded Manchuria in 1931. They have proceeded step by step - phase by phase - looking back over their shoulders at us after each move. When we failed to do more than protest, they proceeded with the next move and have grown increasingly bolder. I am convinced they can be stopped by firmness, by a progressive program of pressure, backed by the will to fight if necessary as a last resort. It will be this realization by them of that determination on our part which will stop them.

27. There are many ways and means to apply this pressure. We have already intimated retaliation in kind in our note of October 6th. It is to be hoped that we take steps to implement it. For immediate use there is the elastic tariff scale and I believe its use thoroughly justified immediately in respect to situations such as now exist at Tsingtao and other North China ports in the manipulation by the Japanese of their Federated Bank currency in discrimination against our merchants. Further and more drastic steps will have to be authorized by legislation and our every move should be directed toward obtaining what we need in this respect.

28. Ours is no longer a question of pulling the British chestnuts out of the fire. The time has come when we must act to save our own, for they are already scorching. If we save theirs for them in the process, that will be their good fortune -- and possibly not such an unfortunate result for us at that!

Respectfully submitted,

J. H. McHugh  
 Captain, U.S.N.C.  
 Assistant Naval Attache.

AIDE MEMOIRE OF CONVERSATION BETWEEN THE GENERALISSIMO  
AND SIR ARCHIBALD CLARK KERR ON NOVEMBER FOURTH, 1938.

(Verbatim Copy)  
(Enclosure B to Report No. 10-38, dated 30 Nov. 1938)

The Japanese occupied Canton with two motives in mind. The first is the effect of such occupation upon China, and the second is the effect upon Great Britain. To strike at China is of secondary importance while to strike at Great Britain is of major importance. By occupying Canton, Japan only cuts the Canton-Hankow Railway and blockades the waterways impeding transportation and stopping supplies of munitions. Canton, too, is an important base for national resistance, and Japan hopes by its occupation to break down the morale of the Chinese people. However, the cost of landing and maintaining her forces there will not be compensated by the above results alone. But in striking a death blow at Britain's historical prestige and traditional morale, she immeasurably enhances her own position and value. The present blow to Great Britain is not as great in effect as it will be in the future. Japan hopes that just as Britain's power and prestige suffer in South China, hers will rise proportionately in the eyes of the Chinese and all Asiatic peoples.

Thus she hopes to occupy completely the historical place formerly enjoyed by Great Britain during the last hundred years as the dominant factor in Far Eastern affairs.

By the successful occupation of Canton, Japan hopes that the old reliance of China upon Great Britain will now be abandoned in favor of Japan. Japan thinks that if she can break down British influence in South China she can break it down elsewhere. And the British Government and people may well ponder what the answer will be.

What I want to know is, "What will be Great Britain's Far Eastern policy in view of this latest move on Japan's part?"

Will Great Britain view the occupation of Canton in the same light as she viewed the occupation of Manchuria, North China and Shanghai?

Moreover, what will Great Britain do in view of this latest development?

I would like to have a definite answer to this question.

In view of the fact that Great Britain's interests and prestige are threatened, will she quietly accept this fait accompli or will she demonstrate in no unmistakable terms her real intentions unequivocally, to safeguard her economic and political interests in the Far East, and, above all, to follow her historical policy of upholding high principles to which she has committed herself, or will she abandon these principles and sacrifice her standing?

China has been fighting lone-handedly for the past sixteen months. We have looked to Great Britain and hoped for help, but up to the present we have received nothing tangible. We appreciate that we secured munitions through Hong Kong, and upon a mutually advantageous basis, but that avenue has now been closed.

As long as South China was not attacked, we made allowances for Britain's hesitancy to extend practical aid to us, but now that Japan has cut off British trade there is no reason why Britain should hesitate to extend help to us.

As time goes on, our people and the Chinese army will become more and more disappointed in view of the absolute lack of concrete and tangible evidence of British support. And that is something which the Chinese Government will be constrained to take into account.

I would, therefore, like to know whether Great Britain will adhere to her obligations as a member of the League of Nations, live up to her historical and traditional standards, and extend economic or some other practical help to China?

I would like to have this answered in a definite "Yes" or "No".

For the past sixteen months we have been hearing a lot of discussion about loans, and we have been put off from time to time with excuses that loans were impossible because of Parliamentary complications. But the whole world witnessed the granting almost overnight to Czechoslovakia of a loan similar in nature to that asked for by China.

Now the moment has come when we must have definite knowledge of Great Britain's intentions.

If Great Britain turns her back alike upon us and her principles, then I shall never bring up this question again. Nor shall I ever mention anything concerning Great Britain's Far Eastern policy. Nor shall I consult Great Britain as to China's future policy or attitude, or anything concerning the Far East.

I can hardly believe, however, that an Empire which produced such statesmen as Disraeli and Gladstone could fail to see the significance of the repercussions of the occupation of Canton, and the inactivity of Great Britain upon her future in the whole of Asia.

This is the life and death turning point in British Far Eastern policy. Whether Britain extends aid to us or not - the British Government should realize that China today is unified as never before, and that we are determined to carry on prolonged resistance. Japan is unquestionably striving to have peace, on terms, however, not beneficial to Great Britain, and thus excluding her from Asiatic affairs, Japan would be willing to concede the gains she has acquired since hostilities began. If that question comes up, what is China's answer going to be?

If Japan wins the war, the old and outstanding interests of Great Britain in China will be finished.

We must know what Great Britain's answer is to be, because upon it depends the future policy of the Chinese Government. There are several roads open to us.

One thing that must be kept in view is that Japan, having occupied Canton, will probably occupy Hainan Island. What such a move will pretend to Hong Kong can be left to the imagination.

In view of the importance of the questions raised in this conversation, will you kindly communicate immediately with the British Government and let me have a reply?

## CLASS OF SERVICE

This is a full-rate telegram or Cablegram unless its designated character is indicated by a suitable sign above or preceding the address.

# WESTERN UNION

H. S. WHITE  
PRESIDENT

NEWCOMB CARLTON  
CHAIRMAN OF THE BOARD

J. C. WILLEVER  
FIRST VICE-PRESIDENT

## SIGNS

DL = Day Letter

NM = Night Message

NL = Night Letter

LC = Deferred Cable

NLT = Cable Night Letter

Ship Radiograms

See filing time as shown in the date line on full-rate telegrams and day letters, and the time of receipt at destination on all messages. **STANDARD TIME.**  
received at 108 East Baltimore St., Baltimore, Md.

CA14 811 NL COLLECT 7 EXTRA 1/141=SANTAMONICA CALIF 19

DR ISAIAH BOWMAN= 697-35

OAK PL BALTO=

THE FOLLOWING STATEMENT PREPARED AFTER CONSULTATION WITH MY COLLEAGUES DOCTORS FITZGIBON POLITICAL SCIENCE AND HUSSEY HISTORY BOTH OF WHOM SPENT RECENT MONTHS IN CENTRAL AMERICA. THIS SUMMARIZES OPPORTUNITIES FOR AGRICULTURAL COLONIES. INDUSTRIAL AND COMMERCIAL OPENINGS FOR LIMITED NUMBER MIGHT BE EXPECTED IN TIME. WAGES FOR AGRICULTURAL AND INDUSTRIAL LABOR EXTREMELY LOW IN ALL SECTIONS. ROAD SYSTEMS BEING ACTIVELY EXTENDED IN MOST COUNTRIES AND AIR SERVICE MAKES MANY REGIONS NEWLY ACCESSABLE.

9 COSTARICA OFFERS BEST POSSIBILITIES FOR SEVERAL 10,000 GROUPS. COUNTRY DEMOCRATIC AND SYMPATHETIC TOWARD IMMIGRATION. UPPER RIM OF MESETA CENTRAL AND UPPER SLOPES BEYOND THAT RIM CONTAIN FERTILE VOLCANIC SOIL WELL DRAINED EASILY CLEARED AT ELEVATION OF 3,000 TO 6,000 FEET. WHILE LOWER ELEVATIONS OF MESETA ARE THICKLY PEOPLED HIGHER ELEVATIONS ARE SPARSELY INHABITED. DISTANCE TO MARKET NOT GREAT OVER FAIR ROADS RAPIDLY BEING IMPROVED. CLIMATE EXCELLENT. WESTWARD SLOPE TOWARD=

## CLASS OF SERVICE

This is a full-rate Telegram or Cablegram unless its de- scribed character is in- dicated by a suitable sign above or preced- ing the address.

# WESTERN UNION

R. W. WHITE  
PRESIDENT

HEWSON B. CARLTON  
CHAIRMAN OF THE BOARD

J. C. WILLEVER  
FIRST VICE-PRESIDENT

## SIGNS

DL = Day Letter
NM = Night Message
NL = Night Letter
LC = Deferred Cable
NLT = Cable Night Letter
Ship Radiogram

The filing time as shown in the date line on full-rate telegrams and day letters, and the time of receipt at destination apply to all messages. STANDARD TIME received at 108 East Baltimore St., Baltimore, Md.

CA14 2/160=

NICARAGUA ALSO SPARSELY INHABITED AND ABOVE 3,000 FEET OFFERS POSSIBILITIES PARTICULARLY ABOUT HEADWATERS OF SAN CARLOS AND ON PACIFICWARD SLOPE. PENINSULA OF NICOYA ALSO OFFERS POSSIBILITIES AS DOES RATHER ROUGH MOUNTAIN TERRAIN OF TALAMANCA CORDILLERA. MOST OF REGIONS MENTIONED ARE SUITABLE FOR CEREALS BEANS AND FRUITS FOR SUBSISTANCE AGRICULTURE AND COFFEE FOR EXPORT. THIS COUNTRY PARTICULARLY ATTRACTIVE BECAUSE POPULATION IS MOSTLY WHITE.

HONDURAS. MOST OF HIGHLAND 3,000 TO 5,000 FEET ELEVATION CONTAINS SPARSE POPULATION. THE SOIL IS GOOD THE RAIN VARIES FROM 30 - 50 INCHES RESULTING IN A GOOD GROWTH OF VEGETATION AND EXCELLENT FORESTS OVER MUCH OF THE AREA. LONG DRY SEASON FROM NOVEMBER TO APRIL OFFERS A PROBLEM AND HAS HELPED TO KEEP AGRICULTURAL DEVELOPMENT DOWN BUT SHOULD NOT PREVENT EXTENSIVE PROFITABLE GRAIN FARMING IF ROADS ARE CONSTRUCTED AS OUTLETS TO MARKET THOUGH INTENSIVE AGRICULTURE MAY NEVER BE POSSIBLE. A MUCH LARGER ANIMAL POPULATION SHOULD BE POSSIBLE ALSO WITH INTELLIGENT MEASURES AGAINST TICKS WHICH NOW CONSTITUTE A SERIOUS HANDICAP=



## CLASS OF SERVICE

This is a full-rate telegram or Cablegram unless its deferred character is indicated by a suitable sign above or preceding the address.

# WESTERN UNION

R. B. WHITE  
PRESIDENT

NEWCOMB CARLTON  
CHAIRMAN OF THE BOARD

J. C. WELLS  
FIRST VICE-PRESIDENT

## SIGNS

DL = Day Letter
NM = Night Message
NL = Night Letter
LC = Deferred Cable
NLT = Cable Night Letter
Ship Radiogram

The filing time as shown in the date line on full-rate telegrams and day letters, and the time of receipt at destination as shown on all messages, is STANDARD TIME.  
received at 108 East Baltimore St., Baltimore, Md.

CA14 3/160=

NOV 20 AM 4 23

MINING TOO OFFERS GOOD POSSIBILITIES KNOWN DEPOSITS OF GOLD AND SILVER BEING NUMEROUS. THESE AREAS ARE SUITABLE FOR PIONEER SETTLEMENTS AND WITH FURTHER EXTENSION OF ROADS AND RAILROADS SHOULD SUPPORT MANY 10,000 GROUPS. PINE LUMBERING INDUSTRY ALSO PROMISING. ATTITUDE OF GOVERNMENT TOWARD IMMIGRATION DOUBTFUL.

9 NICARAGUA. UPLANDS FROM MATAGALPA TO UPPER SEGOVIA REGION SPARSELY INHABITED BUT CAPABLE OF SUSTAINING TWO OR THREE 10,000 GROUPS BY SUBSISTANCE AGRICULTURE, TROPICAL AND SUBTROPICAL HORTICULTURE, AND COFFEE PRODUCING FOR EXPORT IF MARKET EXISTS. ROADS FROM MANAGUA AND TO ATLANTIC COAST RIVERS BEING IMPROVED.

9 GUATEMALA. TWO REGIONS OFFER GOOD PROSPECTS. HIGHLANDS OF ALTA VERA PAZ 3,000 TO 4,000 FEET ELEVATION HAVE HEALTHFUL CLIMATE, RICH SOIL, ABUNDANT VEGETATION; HEAVY RAINS, BUT WITH GOOD DRAINAGE DUE TO UNDERLYING LIMESTONE. ROAD SYSTEM UNDER CONSTRUCTION; RAILWAY AND RIVER OUTLET TO LIVINGSTON; AIR LINE TO GUATEMALA CITY. ANOTHER REGION IS HIGHER PART OF WESTERN END PACIFIC COASTAL PLAIN EAST AND WEST FROM COATEPEQUE AND ALONG FOOT OF VOLCANIC RANGE=

**Rules of Service**

This is a full-rate Telegram or Cablegram unless its deferred character is indicated by a suitable sign above or preceding the address.

# WESTERN UNION

R. S. WHITE  
PRESIDENT

NEWCOMB CARLTON  
CHAIRMAN OF THE BOARD

J. C. WILLEVER  
FIRST VICE-PRESIDENT

**SIGNS**

- DL = Day Letter
- NM = Night Message
- NL = Night Letter
- LC = Deferred Cable
- NLT = Cable Night Letter
- Ship Radiogram

The time shown in the date line on full-rate telegrams and day letters, and the time of receipt at destination as shown on all messages, is STANDARD TIME.  
 Received at 108 East Baltimore St., Baltimore, Md.

NOV 20 AM 4 25

CA14 4/178=

(4)

EASTWARD FROM THERE. THIS IS PIEDMONT SLOPE ABOUT 1,000 FEET HIGHER THAN NEIGHBORING UNITED FRUIT COMPANY BANANA REGION, WELL DRAINED VOLCANIC SOIL SUFFICIENT RAINFALL AND EXCELLENT WATER SUPPLY. SOME DANGER OF MALARIA. GOOD FOR CATTLE, SUGAR CANE, CORN, BEANS, TROPICAL AND SUBTROPICAL FRUITS. ROADS LEAD TO GUATEMALAN HIGHLANDS AND RAILROADS TO PORTS OF OCOS AND CHAMPERICO. PRESUMABLY THE PETEN REGION THOUGH ONCE OCCUPIED BY POPULOUS MAYAN CITIES IS IMPOSSIBLE NOW UNLESS AN EXTENSIVE PROGRAM OF MALARIA ERADICATION COULD BE CARRIED OUT. THE TWO RECOMMENDED GUATEMALAN REGIONS ALREADY CONTAIN MANY GERMAN FINCAS, MAINLY COFFEE FARMS, ALSO SOME INFLUENTIAL ENGLISH AND AMERICAN FARM OWNERS. SUBTROPICAL HORTICULTURE AS YET UNEXPLOITED BUT PROMISING. GOVERNMENT LIKELY TO FAVOR IMMIGRANTS, BUT SOME FOREIGN LAND OWNERS LIKELY TO OPPOSE. IN BOTH REGIONS IMMIGRANTS MIGHT BETTER BE SCATTERED THAN CONCENTRATED IN COMPACT COLONIES. AVAILABLE LANDS OCCUR IN LIMITED TRACTS.

9 BRITISH HONDURAS. (BELICE) INTERIOR HILL COUNTRY OF THE SOUTH WOULD SEEM TO OFFER PLACE FOR MANY SETTLERS IN COUNTRY BETTER THAN IN BELICE WHERE OVER 1,000 WHITES ALREADY LIVE. THIS WOULD STRENGTHEN BRITAIN'S HOLD ON THE TERRITORY. =

## CLASS OF SERVICE

This is a full-rate Telegram or Cablegram unless its deferred character is indicated by a suitable sign above or preceding the address.

# WESTERN UNION

R. S. WHITE  
PRESIDENT

HEWCORE CARLTON  
CHAIRMAN OF THE BOARD

J. C. WILLEVER  
FIRST VICE-PRESIDENT

## SIGNS

DL = Day Letter  
NM = Night Message  
NL = Night Letter  
LC = Deferred Cable  
NLT = Cable Night Letter  
Ship Radiogram

The sailing time as shown in the date line on full-rate telegrams and day letters, and the time of receipt at destination as shown on all messages, is STANDARD TIME.  
received at 108 East Baltimore St., Baltimore, Md.

1920 NOV 20 AM 4 25

CA14 5/172=

(5)

PANAMA. THE PACIFIC SLOPE WESTWARD FROM THE CANAL TO THE COSTARICA BORDER WOULD SEEM TO OFFER ROOM AND SUITABLE CONDITIONS FOR SEVERAL 10,000 GROUPS. ISOLATED VALLEYS WITHIN THE CHIRIQUI MOUNTAINS ALSO OFFER LIMITED SITES AT ELEVATIONS OF 1,000 TO 2,000 FEET. THE COASTAL PLAINS ARE SPARSELY INHABITED AND THE FOOTHILLS LARGELY UNDEVELOPED. THE REGION IS DRY ENOUGH FOR HEALTHFUL LIVING, BUT WITH SUFFICIENT RAIN FOR PASTURE, CEREAL CULTIVATION AND FRUIT GROWING. ACCESS TO PORTS IS EASY AND A ROAD FROM THE CANAL REACHES TO BEYOND DAVID.

¶ SALVADOR. THIS COUNTRY PROBABLY OFFERS NO POSSIBILITIES DUE TO DENSE POPULATION AND INTENSIVE DEVELOPMENT. GENERAL CONSIDERATIONS.

¶ HUMID LOWLANDS HAVE NOT BEEN SUGGESTED BECAUSE OF UNSUITABLE HEALTH CONDITIONS. EACH OF THE SEVERAL COUNTRIES COULD PROBABLY ABSORB A LIMITED NUMBER OF INDIVIDUALS PARTICULARLY OF THE PROFESSIONAL CLASSES AND THOSE FINANCIALLY ABLE AND PREPARED TO UNDERTAKE INDUSTRIAL OR HORTICULTURAL ENTERPRISES. WE WOULD STRESS SUBTROPICAL HORTICULTURE FOR COLONY ACTIVITY, AS YET UNTRIED ON LARGE SCALE BUT EVERYWHERE SUCCESSFUL ON A SMALL SCALE. =

GEORGE M MCBRIDE 710 VIA DE LA PAZ  
PACIFICPALISADES CALIF.

THE JOHNS HOPKINS UNIVERSITY  
BALTIMORE, MARYLAND

OFFICE OF THE PRESIDENT

November 21, 1938

Dear Mr. Morgenthau:

Here is a copy of the letter which I have sent to Warm Springs. It summarizes our conversation last night in so far as South America is concerned. see pg. 16

This leaves the roast duck, the hospitality, and the charm of your home unmentioned. It was delightful!

Sincerely yours,

Isaiah Bowman

Mr. Baruch telegraphed today for 6 copies of "Limits of Land Settlement" to be sent to Carlton Hotel in Wash<sup>DC</sup>. Thought you ought to know this.

The Honorable Henry Morgenthau, Jr.  
Secretary of the Treasury  
15th Street and Pennsylvania Avenue  
Washington, D. C.

NC

A portion of this telegram must be closely paraphrased before being communicated to anyone. (B)

BERLIN (Part Air)

Dated November 20, 1938

Rec'd 9:10 a.m. 21st.

Secretary of State

Washington

641, November 20, 10 a.m.

(Gray) Number 32. FOR TREASURY FROM HEATH.

The Reich's tax revenues for October last were 1367 million marks, an increase of roughly 20 % over October 1937 revenues of 1143 million marks. For the first seven months of the current fiscal year tax revenues totaled 9670 million marks an increase of some 22% over collections of 7943 million marks during the corresponding period last year.

With the imposition of the confiscatory and punitive levy on the Jewish community of one billion marks it is assumed that the revenue forecast of 17.2 billion marks for the current fiscal year should be correspondingly increased. It is not yet possible to state what percentage of Jewish property will have to be sacrificed to meet this levy. Economics Minister Funk stated that total Jewish property had a registered net value of seven billion marks. This evaluation is undoubtedly high inasmuch as the registration decree required Jews to capitalize pensions, declare life insurance policies at <sup>face</sup> value and furniture and other property of little sale value at the purchase price.

NC -2- #641 from Berlin, November 20, 1938

The tendency was to overstate the value in view of the severe penalties prescribed for undervaluation. Funk admitted that of the property registered some two billion marks had already been "Aryanised". To this loss must be added the destruction of Jewish property during the recent "riots" commonly estimated at about half a billion marks and the continuing loss due to the forced or panic sales of businesses to Aryans and hasty realization of property to meet the tax levy and living needs. The situation is rendered more severe by restrictions on Jewish bank accounts and the injunction against sales of Jewish owned securities by banks and the stock exchange.

The Reichsbank statement for the first half of November shows a remarkable ratio of repayment of the Reichsbank credits granted during October: 94.8% as compared with a repayment of fresh credits of 77.7% for the first of November, 1937. It is possible, however, that this decrease in Reichsbank credits may have been offset by counter activity of the Gold Discount Bank which publishes its statement only once a month. Thus during October when the Reichsbank decreased its bill holdings by 631 million marks its subsidiary, the Gold Discount Bank, increased its bill portfolio by 311 million marks. The total of Reichsbank credits: bills checks collaterals, decreased 250 million marks

NO -3- 641 from Berlin, November 20, 1938

marks during the second week of September to 7648 million marks a figure 774 million under that of October 30. Bills discounted the largest item of Reichsbank's credits stood at 6775 million marks on November 15th as compared with 7542 million marks on October 31 and 5578 million marks on October 31, 1937.

Total currency circulation decreased 253 million marks during the second week to a total of 9253 million marks on November 15th as compared with a circulation of 9266 million marks in mid-October last and 6756 million marks in mid-November 1937. The high cover currency circulation was 10154 million on September 30 last.

Financial authorities have admitted that with due allowance for the annexation of Austria and Sudetenland there has been an increase in currency circulation of 25% over that of a year ago. This increase in currency circulation compares with the estimated increase of salaries and wages during the first half of 1938 of 1.5 billion marks or 7.6% over wage payments of the first half of 1937. The Institute for Economic Research estimates the rate of increased production of capital investment industries during the first eight months of this year at about 10% over that of 1937 and the average of other industrial groups at about 5%. Consumption goods industries working from elastic demand are estimated to have increased their production by 7.6% over 1937. Undoubtedly one factor in the increased

monetary

NC -4- #641 from Berlin, November 20, 1938

monetary circulation is "hoarding" by wage earners not permitted to expend their increased earnings for foods and by individuals desirous of keeping a portion of their <sup>fortunes</sup> from the knowledge of tax and other authorities.

The announcement yesterday of a new Reich loan of  $1\frac{1}{2}$  billion marks before the final payment on the October loan (December 5) had been made came as a general surprise although it might have been anticipated. The new loan will also be issued at 98  $\frac{3}{4}$ % and bear interest at  $4\frac{1}{2}$ %. The term of subscription will run from November 28 to January 9 and the term of payment from January 17 to February 25. As with the October loan subscribers have the option of taking receipts for their subscription, the bonds being deposited to their account in some central "security bank" to be designated.

The new loan is announced in the financial press under such headings as "utilization of money market surplus". It is true that contrary to the results of previous issues which were followed by a hardening of the money market the October loan was succeeded by an unusual liquidity evidenced by increased issues of Gold Discount Bank single bills and the remarkable-- 94.6%--liquidation of fresh credits of the Reichsbank during November. This condition was mainly the result of the maturing on October 31 of several hundred million marks of short term Treasury bills--"delivery certificates" issued to Government suppliers and non-

interest



interest bearing bills sold on the money market. On December 1 several hundred million more Treasury certificates will fall due as well as an unspecified amount of 4 1/2% Treasury certificates issued some years ago. Ostensibly "delivery certificates" and non-interest bearing Treasury bills which have been issued in maturities of three, six, nine and twelve months will be falling due during the period of conversion. To a large extent, therefore, the new loan will be a conversion of short term indebtedness.

The whole story is however not contained in the above. The belief is that this is also a call for the people to increase their savings in order to maintain and increase armament and the concomitant program of the four year plan of the Germans. The newspaper DER DEUTSCHE VOLKSWIRT is known to be close to the Reichsbank, and it is relatively independent in its editorial expression even if such expression is restrained; in an editorial in this paper the need of increased armament is openly discussed. It stated "we must equal the increased (armament) measures of other nations".

Stressing that the increased exertions demanded of the German people must not be at the expense of a diminution of the supply of consumption goods desired by the worker, it refers to speeches by the Finance Minister and Economics Ministry officials calling for a reduction of Government and bureaucracy and over-organization and a decrease in non-essential governmental activities and expenditures. The

editorial

NC -6- #641 from Berlin, November 20, 1938

editorial points out that the new demands on the German people must be met by better equipment and organization, "rationalization," of industry and approves the recent decree cutting apprenticeship from four to three years. It clearly indicates that longer working hours will be required and greater employment of women in industry. The necessity of increased foreign trade to pay for raw material is emphasized. It approves recent steps for "sharper" calculation of prices in Government orders and speaks approvingly of the measures requiring municipalities to invest a greater portion of their reserves in Government loans.

In this connection it is popularly reported that the municipalities took about one half billion marks of the last and previous Reich loans. According to a recently published study the total reserves of towns of more than 10,000 population were 1.4 billion marks at the end of the 1936-1937 fiscal year. Presumably these reserves have since increased. Since for the 1936-1937 period these municipalities had an aggregate budget surplus of 381,000,000 marks. (End Gray)

GILBERT

WFC  
HPD

ADDRESS OFFICIAL COMMUNICATIONS TO  
THE SECRETARY OF STATE  
WASHINGTON, D. C.

30



DEPARTMENT OF STATE  
WASHINGTON

A large, abstract handwritten scribble in black ink, consisting of several overlapping loops and lines.

November 21, 1938.

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury, and encloses for his strictly confidential information a copy of telegram No. 1957 of November 18 transmitting the substance of a conversation which the Chargé at Paris had with the Air Minister of France.

RECEIVED  
10:15 am  
NOV 21 1938  
TREASURY DEPARTMENT  
Office of the Secretary  
Financial Assistant to the Secretary

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: November 18, 1938, 8 p.m.

NO.: 1957

The following is strictly confidential:

Today I had lunch with Lachambre, the Air Minister. At the meeting of the Radical Socialist Deputies this morning, he told me, out of about a hundred present (himself included) eight of the deputies had voted against, and twenty abstained on a resolution expressing confidence in the Government to improve the country's economic situation but omitting specific reference to the decree laws recently promulgated. In view of the criticism of the decree laws, Lachambre was pleasantly surprised that there was no greater opposition on the part of the Radical Socialists.

If the Government should be overthrown next month, Lachambre believes that a National Union Government will come in headed either by Bonnet or Daladier, and members of the Center and the Right will be taken in. In its fundamentals, the financial program of such a government would not be much different from the present one of Reynaud. Slight modification would have to be made in order to mollify the most vehement of the present critics and of course Reynaud would have to go.

Lachambre told me that the rumors about prolongation of the life of the present Chamber were "fantastic". He knew that no such thing was contemplated by Daladier.

Yesterday

- 2 -

Yesterday the C.G.T. held National Congress meeting at Nantes. They decided to observe the twenty-sixth of November as a day of protest against the decrees of Daladier and Reynaud. This organization instructed its administrative committee to initiate resistance to the decrees and even to go so far as to plan to cease work if necessary to defend the social reforms.

Last Saturday the veterans organizations had given Daladier such an ovation when he called upon them to make voluntary sacrifices in line with the urgent need for economy in governmental expenditures; however, yesterday this form of support was refused to the Prime Minister on the grounds that the decree laws cannot be expected to solve the country's problems, and because they are not equitable in the distribution of the burden placed on the population.

The appeal for support of the "three year plan" was renewed last night in talks before the federation of French newspapers by the Prime Minister, the Finance Minister and the President of France. Some of the phrases which the Prime Minister used in his speaking illustrate the atmosphere created by the conflict over the plan; the gist of them was that the Prime Minister would not yield to any of the maneuvers of the adversaries of the Government, that he despised their threats, and that they would not be successful in breaking their will nor in reducing French enthusiasm

- 3 -

for recovery.

In the speech given by the Minister of Finance it was pointed out that the "yawning abyss at France's feet" had been lost sight of in the hubub which had arisen over the taxation provisions of the plan - which problem had been prostrated by him without stint last Saturday night. It had also been overlooked he said that the plan is principally one of economic recovery.

The speech given by the President was less instructive on the purpose or details of the program, but it expressed the fervent hope that the country and Parliament would give the recovery program their full support. As a gauge of the seriousness of the present situation, the President's speech was perhaps the most interesting. The Chief of State stepped somewhat out of role for the second time (he had made a speech last Saturday) and made an appeal for the particular program of a particular Government.

The political press reports of yesterday and today mention the innumerable rumors that are going around as to the methods that some newspapers fear may be adopted - and which others believe should be adopted, depending on the point of view of each journal - for the continuance in power of the authors of the recovery plan for the time believed necessary to assure the program's success. It would be useless to speculate about the relative value

- 4 -

of these rumors in view of the present confused situation. It is highly probable that the rumors are based upon not much more than the imagination of their authors and the general uncertainty as to the outlook for the future.

END MESSAGE.

WILSON.

EA:LWW

RECEIVED  
FEB 21 1918  
U.S. DEPARTMENT OF STATE

STATE DEPARTMENT

CABLE

November 21, 1938

PARIS

FROM AMERICAN EMBASSY

#1966.

Reference is made to telegram #870 of November 19 from the Department. I am in agreement. Cochran will sail for the United States on November 26 on the Queen Mary.

(Sgd.) Wilson



November 21, 1938.  
2:16 p.m.

26

Operator: Go ahead.

HMJr: Hello.

Harry  
Hopkins: Hello Henry.

HMJr: How are you?

H: Fine.

HMJr: Harry.

H: Yes.

HMJr: I'm calling you up to ask you whether you would inform me where the Administration stands on this relief situation as of today?

H: Well, Henry, you know I can't answer that one to you off on - over the phone as to where -

HMJr: No.

H: As to where - what my thinking is.

HMJr: Well, what I'm getting at is this.

H: What conversations I've had with the Boss.

HMJr: No, no, no. That's - Are you going to do anything today?

H: Am I going to do anything today?

HMJr: Yes.

H: No. I'm going to make some moves around my own shop but nothing serious.

HMJr: Well that -

H: I'm going - I'm going, you know, I'm going - I'm making moves today.

HMJr: Well let me tell you what -

H: Not major moves.

- 2 -

HMJr: Well let me tell you what I have in mind. I've never - I - we had a meeting this morning of this new committee that the President set up on fiscal and monetary.

H: Yes.

HMJr: And I told him about this situation, but I said that if at this time, I'm using the word "administration" advisedly, if we layed off a million men that this recovery isn't far enough along but what it would very likely upset the whole applecart.

H: Yes.

HMJr: And therefore we are drafting a letter to the President recommending that he sign this National Emergency, see?

H: Yes.

HMJr: But I don't want to leave a stone unturned.

H: Yes.

HMJr: And if you are so inclined I'd like very much if you would drop over here at five o'clock and see the letter before it goes to the President.

H: Yes. Well I will. Now, when can I see you?

HMJr: When can you see me?

H: Yes.

HMJr: Well -

H: I'm going to be here all week and I've got no appointments.

HMJr: Well you can see me any time that you want to.

H: When - is there any chance of you and I having dinner together?

HMJr: Well unfortunately -

H: At your house.

HMJr: Well here's the thing. We're going to Woodrings tonight, tomorrow night we've got guests, but I'm free at lunch tomorrow.

- 3 -

H: When are you going for Thanksgiving.

HMJr: Right after - around noon Wednesday.

H: Well, can you lunch with me tomorrow?

HMJr: Well you can lunch with me. I don't ever go out.

H: All right, I'll come down when?

HMJr: One o'clock.

H: All right, and I'll be down at five this afternoon.

HMJr: But if you'll come down at five -

H: I'll be down.

HMJr: Now Harry, I appeal with greatest secrecy on everybody on this.

H: All right. I won't say anything to anybody. I won't talk to anybody in my shop about it.

HMJr: I mean I've told them that I've never done anything which was so secret because this is the President's business.

H: That's right.

HMJr: And -

H: Will there be anybody else there at five?

HMJr: Yes.

H: Well, I'll be discreet about what I say.

HMJr: But the point is, I haven't - all I'm saying to them is never mind what happened in the last six weeks.

H: Yes.

HMJr: This is the situation.

H: Yes.

HMJr: And while I have no legal responsibility I got some sense of what's best for the country and what's good for the unemployed and the human being, and I'm not going to

- 4 -

be satisfied until I've done everything I can to get him to sign this.

H: Well Henry I'll be down at -

HMJr: But as I say I have surrounded everybody with the utmost - and I've got a fellow going down - my own age - going down on the plane tonight at eight with this letter. But I didn't want to send this without you seeing it and having you say, "Well that's swell or it isn't".

H: Yes.

HMJr: See?

H: Fine. And I'll be there at five.

HMJr: How does it sound to you offhand.

H: Oh, fine, and I was - I was simply going to go down there myself and - I got no chance to discuss this the other day with him, he just gave me a public beating which I sat and took.

HMJr: Did he just spring that on you?

H: Sure.

HMJr: Well I'll be damned.

H: But I know why he did it.

HMJr: Well I don't.

H: Because I had planned to have the orders issued to reduce these people and the orders were withdrawn at his specific request.

HMJr: I see.

H: So it was all, I figured that he just decided to give me a public beating in front of a lot of people. Whatever the reason is, by God, he had some reason for doing it, and whatever the reason is, Henry, is all right with me.

HMJr: But why, Harry?

H: Well, don't ask me. I can't tell you why.

- 5 -

HMJr: Do you know?

H: I've got an idea, but I'd rather not talk to you over the phone.

HMJr: Well anyway -

H: Well I'll be in at five, Henry.

HMJr: O.K.

H: And it sounds all right to me, see?

HMJr: All right.

H: Fine. Goodbye.

REB

GRAY

London

Dated November 21, 1938

Rec'd 2:17 p. m.

Secretary of State,  
Washington.

1341, November 21, 5 p. m.

FOR TREASURY.

After Saturday's rather active day in the bullion and foreign exchange markets today has been very quiet with only 87 bars sold at the fixing at 147 shillings 11-1/2 pence giving a premium of a half penny at 4.70, 52 bars being married. The British authorities held sterling at 4.70 in the morning but receded to 4.69-1/8 this afternoon when the dollar was bid chiefly as a result of the Bank of France's purchases of dollars and sales of sterling the latter at 178.69 earlier in the day and later at 178.66. Forward rates of the franc are thought by the market also to have been subject to control by the French authorities and now stand at 1.1 for one month and 3-1/8 discount for three months.

KENNEDY

KLP

RGC

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: November 21, 1938, 3 p.m.

NO.: 1966

Reference is made to telegram No. 870 of November 19 from the Department. I am in agreement. Cochran will sail for the United States on November 26 on the QUEEN MARY.

WILSON.

EA:LWW

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: November 21, 1938, 6 p.m.

NO.: 1968

FROM COCHRAN.

At six o'clock I had a talk with my friend in the Bank of France. The net gain for the day was 1,300,000 pounds, although the fund yielded a little foreign exchange in late trading as a result of strike stories. Better market for forwards, General improvement in French rentes and shares. I understand that \$6,000,000 was yielded by the British control, and that the failure of the pound to improve after completion of the Anglo-American trade agreement has caused gloom in London financial circles.

Tomorrow the Prime Minister and Reynaud are scheduled to go before the Finance Committee of the Chamber to present their budget plans for 1939. Today there is improved market and press reaction because of the expressed determination of the above two officials to see their program through.

END SECTION ONE.

WILSON.

EA:LWW



REB

GRAY

Paris

Dated November 21, 1968

Rec'd 3:39 p. m.

Secretary of State,  
Washington.

1968, November 21, 6 p. m. (SECTION TWO)

In his weekly editorial financial editor Jenny of LE TEMPS today concluded a study of Reynaud's as follows:

"What do the opponents propose to substitute for the sacrifices demanded of the taxpayers-consumers? Exchange control? That is not serious. Monetary control does not at all modify the essentials of the problem; remedies nothing. It masks for a while the consequences of inflation without suppressing them. It can postpone the catastrophe. It can prevent it. In order that it may be avoided it is indispensable that the sacrifice demanded of everyone be accepted and that the Government know how, if it must, to brave for some time an unpopularity which is to be expected."

Bank of France today invoiced to Federal Reserve Bank, New York for account of Bank of England 477,000,000 francs gold bars CHAMPLAIN.

Press

REB

2-#1968, From Paris, Nov. 21, 6p.m.  
(Sec. Two)

Press reports from Havre rifling by dock workers of  
cases of silver coins in a Valencia government shipment to  
New York PRESIDENT ROOSEVELT.

(END OF MESSAGE)

WILSON

NPL

COPY

November 21st, 1938

My dear Mr. President:

The map which I promised to send you in answer to your second inquiry was delivered to Secretary Morgenthau at his home in Washington last evening and he and I spent the evening examining it and other maps and documents. He will write you about them. My purpose in writing this letter is to summarize the results of an inspection of Northern South America. You will find detailed summaries region by region pasted on the map itself.

The two critical contours on the map are the 3,000 foot contour and the 8,000 foot contour. Below the first the tropical conditions are severe; under 2,000 feet and between 2,000 and 3,000 feet they are still difficult for European colonists. Any site below 3,000 feet would offer special technical difficulties in the field of health and outdoor labor. Also, there would be required forms of tropical agriculture, which are both specialized and difficult for European labor. Above 3,000 feet the climate is distinctly better, horticulture is possible, subsistence farming is practicable and it is possible for the European to become adjusted to both elevation and climate. Above 8,000 feet pulmonary and heart troubles increase rapidly. Eighty percent of the population of highland Bolivia and Peru die of pulmonary diseases, mostly pneumonia. If colonists were young they could stand a greater elevation. Even 8,000 feet is extreme for people beyond the age of 50, as a rule.

The net result of an inspection of all these limiting conditions is that Northern South America offers no place for colonization on a large scale, of people such as we have in mind. This will be cleared if the summaries on the map are read in connection with the following text.

#### I. NORTHERN SOUTH AMERICA

##### 1 - The Guiana Highlands

The Guiana Highlands are out of the picture. The land is either rough or swampy, the distances to the Orinoco or other streams is great, road construction is difficult and expensive and the insect inhabitants are both numerous and varied. It would be a major task of reclamation and land modification to make the region habitable and the cost would be excessive. In enterprises of this sort the physically possible and the economically profitable would have to be kept in balance. It would be like a city at the South Pole. Civilization could maintain it, but the cost would be prohibitive.

##### 2 - Venezuela

I described the llanos country in an earlier letter. A word

COPY

here as to the western border of the plains country. Irrigation is necessary and this requires considerable capital to begin with. Irrigated areas will produce products which must be handled expertly if they are to find an outside market; and then comes the difficulty of transport to the market. If there were a tract of favorable climate and terrain that would accommodate 100,000 people, transport might be provided over installed roads to the coast, but no such tract is available. The areas are scattered. They are local alluvial deposits. I will spend no more time on them since from every standpoint they fail to provide the necessary conditions for tolerable living.

### 3 - Highland Colombia

There are a great many local tracts in Highland Colombia which could sustain European inhabitants in comfort and prosperity. The trouble is that they are scattered and each would require a special field survey to determine its capacity and the scale of the facilities that would be required to provide an outlet for colonists. As you see from the map, the highland areas available between 3,000 and 8,000 feet are marginal to a higher plateau. The higher parts of Colombia are already occupied and no displacement of the relatively dense highland population is possible. This means a survey valley by valley and region by region and will take both time and money. In the end, groups of from 500 to 5,000 people would be accommodated. This would all add up to a minor item considering the total population to be relieved.

## II CENTRAL AMERICA

A protégé of mine for some years, Dr. McBride, now of the University of California at Los Angeles, has just returned from a six months' field study of land tenure and land use in Central America. Two of his associates have also studied the region within the past year. At my telegraphic request they have sent me a 1,000 word summary of colonization possibilities in Central America. Secretary Morgenthau will send you a copy of this summary. I left my only copy with him last night to be forwarded to you, together with a covering letter from him.

The summary adds up in brief to this: that only one country has major possibilities and that is Costa Rica. I should estimate a fairly immediate capacity for 50,000 people and possibly a capacity for 100,000 people. The total population of Costa Rica is about 500,000. The available land is located on the western and relatively dry side of the Cordillera. All of the eastern slopes of Central America are heavily wooded and the plains near the coast are jungle-covered, in response to excessive rainfall. It is only west of the mountains or in drier pockets in the mountains that the white race has established itself on an important scale.

From the standpoint of health, marketable production, transport, group settlement, and the like, Costa Rica is unrivalled in Latin America.

## III BRAZIL

### 1 - Eastern São Paulo

Here is a large pioneer zone in process of rapid development. I doubt if Brazil will permit large numbers of foreign colonists to enter this

President Franklin D. Roosevelt

COPY

sons. Her own people need it and their products are of little value for subsistence outside of coffee, and Brazil already has an embarrassing large quantity of coffee. The political aspects of this settlement area outweigh all other considerations and I need not trouble you with details until these political aspects are cleared up. *except*

## 2 - Northeastern Brazil

In view of the experience of some of the colonists in dry land countries at the Eastern end of the Mediterranean, it is worth while to consider the possibility that the Brazilian Government would extend a welcome to such colonists who may help Brazil in reclamation projects in the states of Ceara, Parahyba and Rio Grande Do Norte. This area suffers from recurrent droughts. It is highly productive when irrigated. It is that part of Brazil which corresponds with our dry West. They have borrowed our engineers and our ideas extensively and have made progress. The advantages of settlement here might be summed up in the following terms: fair size group settlement, controlled health conditions, nearness to the sea, settlement based on capital economically expended on technical projects whose character is well known. The low latitude (4 degrees to 8 degrees S) seems to be a drawback, but there is some elevation above the sea and the capital expenditures would sustain low grade labor available elsewhere in Brazil.

## IV BOLIVIA - PARAGUAY

### 1 - Bolivia

There is room for perhaps 50,000 people along the mountain border of Bolivia facing the Gran Chaco. This would require a brief field survey. Now that the boundary line has been settled, development will proceed rapidly. Capital is greatly wanted in Bolivia. The government would probably welcome such a settlement. While the region is within the tropics, its latitude is about 18 to 22 degrees and the elevation sufficient to make it tolerable. No doubt there will soon be a good outlet to the projected new port on the Paraguay River. The greater part of the Gran Chaco is not suited for settlement under present conditions. It is either too dry or flooded very much, as in the case of the llanos of Venezuela.

### 2 - Paraguay

There are possibilities for settlement of perhaps 25,000 people in Paraguay, looking ahead for ten years. The cultural level is low. The colonists would have to bring their culture with them. This requires group settlement and outlets to the Paraguay River. It is no paradise, but space can be found for a quite limited number in relatively small groups. It is not a recommended area.

## V SOUTHERN CHILE

There is only one area in Chile that is still capable of absorbing immigrants. It is the province of La Frontera. Only those colonists who are strong physically should attempt to settle here. The type of settlement is like that in Michigan and Ohio in pioneer days. The hoe and axe would be wielded. Mixed farming is the rule. There is an excess of rain during half

COPY

the year, but the health of the colonists seems good; however, the Chileans themselves need the land. I doubt if it is feasible to induce them to open the door to more than 10,000 people.

VI AFRICA

My time being limited, I have asked for an assistant, who will join me on Wednesday morning at nine o'clock and compile similar summaries of settlement conditions in the former German colonies of Africa and elsewhere on that continent, as well as in South Eastern Asia. Within two weeks at the latest these summaries will be ready, together with appropriate maps. If it is agreeable to you, I will forward them through Mr. Morgenthau, since he will be more closely informed of your whereabouts.

It is an exciting search. May I say that it has given me great pleasure to supply the information that you desire.

Sincerely yours,

Tealsh Bowman

President Franklin D. Roosevelt,  
The White House,  
Washington, D. C.

at head

File 10m Jo



STRICTLY CONFIDENTIALTHE CONVERSATIONS AT CHANGSHA BETWEEN THE  
BRITISH AMBASSADOR AND CHIANG KAI-SHEK

1. The recent talks at Changsha on November 4th and 6th between the British Ambassador and Chiang Kai-shek were not, as had been generally rumored in the press, the medium for the former to convey to the latter peace terms from the Japanese. The shoe was, in fact, quite on the other foot. Chiang Kai-shek did most of the talking, as is indicated in the Aide Memoire of their first conversation, a verbatim copy of which is appended to this report.

2. Although I had felt that Chiang was still adamant on the question of continuing resistance and knew in advance that Sir Archibald's visit was the result of an invitation which the Generalissimo had extended to him during the course of their last meeting at Hankow late in July, I myself was led to believe by the persistent reports coming over the radio news broadcasts just prior to his arrival at Changsha that he might be the purveyor of terms. It was obvious that if Japan could not arrange terms after the almost simultaneous capture of Hankow and Canton, there were no key points or centers in the field ahead of them the capture of which could be used either to bring pressure on the Chinese or which could be publicized in Japan as the "final victory" of the war. I was led to the further suspicion of possible peace efforts by the Ambassador, as his entourage approached Changsha from Kunning, by secretive hints from my friend, the Commanding Officer of HMS "Sandpiper", that he had received very important despatches for H.E. which contained amazingly easy peace proposals. I gathered that either the British Embassy in Shanghai or Tokyo was forwarding these, the general nature of which included a ninety nine year lease on Manchoukuo, demilitarization of China north of the Yellow River, complete withdrawal of Japanese troops to the coast (with certain conditions) and agreement to negotiate with the Kuomintang conditional upon certain changes in personnel and policy.

3. I later discussed these points with Sir Archibald direct. He laughed and said they were what his friend Mr. Tani (the Japanese Minister at Large in Shanghai) had frequently spoken to him about. When he had asked Mr. Tani, however, if he might discuss these terms with the Generalissimo and present them as a formal proposal, Mr. Tani had beaten a hasty retreat, saying they were only his own ideas and not officially approved. (obviously lacking the Army's concurrence)

4. The British Ambassador arrived at Changsha on the evening of November 3rd accompanied only by a young private secretary and his new Military Attache, Lt. Col. C. N. Spear. At the invitation of the Captain of HMS "Sandpiper", I was among those who met him. Mr. Donald had arrived that afternoon from Nan Yueh (Heng Shan), where the Generalissimo was staying, to arrange the talks. The Generalissimo and Madame Chiang came up the same night and went to the private villa of the Governor of Hunan on the outskirts of the city. Chiang Kai-shek had just returned from a trip to Nanchang by car where he had gone for a military conference. (He and his party had flown from Hankow to Hengyang when they evacuated on the night of October 24th and he went to Nanchang soon afterwards.) Sir Archibald expressed pleasure at seeing me when he arrived and immediately inquired in Mr. Donald's presence if we might have a chat while he was there. Mr. Donald had arranged for him to lunch with the Generalissimo on the following day, November 4th, and to have his first talk with the Generalissimo in the course of the afternoon. Sir Archibald thereupon suggested that I come the day following.



5. I met Mr. Donald the next morning while he was waiting to escort the Ambassador to lunch. He discussed in general the failure of the British to live up to their commitments as a member of the League of Nations and help China; their silence over the capture of Canton and the portents of that action to Hongkong; and asserted that it was idle to criticize the Chinese methods of fighting the war. He said they were doing it their own way because they are Chinese, but that what England and the U.S.A. had to decide was whether they wished to see China go under and with that event lose their prestige and potential trade in China, or preserve these by helping China now. He was convinced that if Great Britain did nothing about Canton, her silent acquiescence would have serious repercussions on her prestige elsewhere, especially in India.

6. I saw Sir Archibald the following noon, November 5th, just before lunch, but any opportunity to speak with him privately about his talk the day before was forestalled by the entry of Lt. Col. Spear and the host. He therefore only remarked in general about what had transpired saying that Chiang Kai-shek had asked him some very embarrassing questions as to what London was going to do about Canton. Air raid alarms prevented me from seeing Mr. Donald this date, the foreign residences being on an island in the river and the Chinese soldiers along the banks having the disagreeable habit of taking pot shots at anything which moved during an air alarm. (If one could have been sure they were aiming at him, it would not have mattered, but the danger lay in the stray shots.)

7. I met Mr. Donald the following morning, November 6th, by crossing the river before breakfast to beat the alarms. He remarked, however, that my inability to cross on the previous day had not mattered as he had been busy all morning writing the Aide Memoire of the conversations between the Ambassador and the Generalissimo of the day before. He asked if I had seen the Ambassador and if he had told me about his talk. When I replied that the Ambassador had mentioned the general tone of his talk, but had been precluded by other guests from discussing it, Mr. Donald dilated a bit on the fact that the Generalissimo had bluntly asked London what they were going to do. Mr. Donald discoursed again on the possible results to British trade and influence if they failed to act and then advised me to see Sir Archibald again and ascertain if he would give me the full details of the Aide Memoire. He characterized it as a very important document which he felt Washington should also see, but said he did not feel free to reveal it without permission as my Ambassador would naturally resent any such liberty if he were similarly placed. I informed him that I was to have lunch that noon with the Ambassador and would endeavor to obtain a chat with him later when I felt reasonably sure he would grant the necessary permission.

8. Mr. Donald then informed me that if the democracies fail China at this time, she obviously would have to turn elsewhere and that the question of her policy for the coming year would be the chief point on the agenda at the forthcoming meeting of the Central Executive Committee of the Kuomintang which would take place in Chungking early in December. I inquired if there were any chance of a turn toward Russia and asked if during the intervening period after we had left Hankow at the beginning of August until our return just before the fall of the city the Russians had presented any quid pro quo to the Generalissimo in return for increased aid from them. (Both Mr. Donald and Madame Chiang had repeatedly denied to me in the past that this had ever occurred, saying that China had paid for all of the help she had received from Moscow.) He replied that the Russians now had something over one hundred planes at Lanchow and that they had approached the Generalissimo shortly before the decision was made to leave Hankow with the proposal that

they would make not only those, but as many more available to him if he would agree to continue resistance against Japan. Chiang had snorted and replied that he intended to continue resistance whether they helped or not. (It seems pertinent to remark here, as I have stated previously, that Chiang Kai-shek has been consistent from the very beginning in this respect and in his policy to carry on the war to a finish. He has taken the point of view that his cause is just and that sister democracies could not fail ultimately to come to China's assistance. He has spurned all suggestions of help with conditions attached - viz: the British suggestion last Spring that he remove Dr. Kung.)

9. Mr. Donald then stated that if China turned away from the democracies he thought it would be toward Germany and the totalitarian states; that they had already given far more material aid to China through their barter agreement and military advisors than any other country and that the barter system not only had great potentiality in the post-war reconstruction of China, especially since China would have no money, but that the Germans had proved themselves peculiarly adept at doing business with the Chinese. I inquired how this could be reconciled with the Berlin-Tokyo agreement and where China would stand vis-a-vis Japan in such an event. He then revealed one of the most important points in the Aids Memoire, namely, that the Generalissimo had always known and now had especially good reason to believe that he could get very easy peace terms from Japan anytime he would agree to the exclusion of the British from China. He said he had already advised Chiang, however, that if it came to that point, he should make terms through Berlin rather than directly with Japan. He reiterated his belief that a German-Japanese economic alliance would have a genuine chance of success in developing China after the war. (I had already discussed with Mr. Rogers in Hongkong sometime ago the possibilities of an extension of the German barter system on a grand scale to China, but from the point of view of weaning Germany away from Japan and effecting some kind of understanding with England, France and other states. He had expressed serious concern over the potentiality of this weapon of Hitler's, saying that he was intimately acquainted with Dr. Schacht and respected his ability. It is a question worthy of serious thought, particularly if it includes Japan and excludes the rest of us.

10. I then went to lunch with the British Ambassador and immediately afterward asked if I might have a word alone. He readily assented and took me to his bedroom where he walked up and down and talked without restraint for over an hour. I recorded the following memorandum of this conversation immediately afterward:-

11. I opened the conversation by recalling to him what he had told me the day before of Chiang Kai-shek having faced him with the fait accompli of Canton; mentioned a conversation I had had with Rogers over the possibility of weaning Germany away from Japan in some sort of joint economic agreement with other nations; of the latent possibilities in the barter system; of the belief held by Donald and Captain Stennes that Germany might assist Japan in China by this means; and inquired what he thought of the possibility of China turning away from the democracies completely and reaching an understanding with the totalitarian states.

12. Sir Archibald said that he too had been giving serious thought to this question. He said he had just been engaged all morning in preparing a draft message to London. He said that in his conversation the day previous with Chiang Kai-shek, he had asked Chiang frankly for a statement of his military position and his possibilities for continuing resistance, telling Chiang it was much more desirable to get it from him direct than to have to guess at it. The Generalissimo replied that he now had sixty divisions

north of the river, sixty south thereof and a like number in reserve. (The Ambassador asked me what strength these would represent and seemed surprised when I told him that they averaged five to eight thousand effectives before going into the line and the figures given undoubtedly included many units which by now were mere skeletons.) Chiang had stated that these would soon be reorganized for active guerrilla warfare and that his policy would be to present to the Japanese a constant threat of attack while continuing general resistance, always giving way where necessary to avoid too severe losses and ultimately to choose his own ground for battle. The Generalissimo had said he had supplies for more than a year yet at the 'present state of wastage' and expected to continue his program of resistance unabated.

13. The Ambassador said that Chiang had spoken with great frankness and with considerable agitation on his position vis-a-vis Great Britain. He stated that he had held China together all these months on the plea that aid would be forthcoming eventually from the democratic countries, notably Great Britain, and bluntly asked for a showdown and a simple "Yes" or "No" on the question. He put it up to the Ambassador that if China were not going to obtain aid from Great Britain and the U.S.A she obviously would be faced with turning elsewhere and asked Clark-Kerr what he would do if he were similarly placed. The Ambassador told me he obviously had to agree.

14. Sir Archibald said he had then asked Madame Chiang, who was translating, if the Generalissimo would not come out frankly with what was in his heart. Madame Chiang inquired if he really wanted the truth and the Ambassador replied that they would be much better off to have it out then and there. Chiang Kai-shek became visibly excited at the question and said that Great Britain might as well understand that they were at the parting of the ways. If Great Britain chose to help China, she would have China forever; if she rejected this final appeal then China would turn completely away from Great Britain and never have anything more to do with her; that he himself would never consult Clark Kerr on a single question. The Generalissimo added that the Chinese have long memories and that if Great Britain forsook China at this time, they would never forget it and would make them pay for it ultimately.

15. The Ambassador said that the problem was a very serious one and that he was at a loss as to how best to cope with it. He recalled to me his previous efforts at obtaining a loan for China to support the currency and said he had gotten his Foreign Office completely with him on the question, but had been unable to get the Treasury where he had been blocked by Sir John Simon. He remarked that I no doubt knew the latter's attitude toward Japan. He said that Sir John lived in absolute fear of Japan and was constantly encouraged in this by his colleague in Tokyo (Sir Robert Craigie) who constantly sent home despatches about the power of Japan. Sir Archibald said that he and Craigie differed absolutely on the question of the effect of the present war upon Japan; that he felt the war was a tremendous strain on Japan which sooner or later must produce a general breakdown (he said he felt this might come within another six to eight months time) while Craigie kept insisting that Japan was in no such danger and had not yet felt the strain of the war to any extent. Clark Kerr said that he thought our representatives in Japan lived too cloistered an existence to know the true state of affairs there.

16. Sir Archibald remarked that the loan involved was a relatively small amount and that he was now engaged in drafting a despatch to try and re-open the question. He said that Chiang Kai-shek had mentioned the fact that if Great Britain could only give him something tangible to show the country such as a loan to support the currency he could satisfy them. Clark Kerr was not sanguine as to the prospects of a loan, however. He remarked that T. V. Soong had told him during a recent conversation in Hongkong

that China was endeavoring to establish a stabilization fund of six million pounds sterling to which the Chinese banks would contribute half and had asked if the British banks would contribute the balance. (Rogers conceived this idea in Hongkong in September while I was there.) The Ambassador said that he had first approached the Hongkong and Shanghai Banking Corporation who, while favorably inclined, had refused because there was no ample security for their depositors and bondholders. He had then referred the matter to the Bank of England from whom he had not yet gotten an answer. He remarked that he had quite understood the Hongkong and Shanghai Bank's position, but that the Bank of England could afford to be sentimental and take a chance occasionally as they had done in Austria in 1922 where they had gotten away with it. He stated that he had proposed the original loan to China as the first step of a long-view policy with the second step to be taken next year if the situation were still favorable; that if it proved otherwise it would always be possible to step aside and that the loan itself would always be amply justified as an investment in good-will.

17. The Ambassador then told me the following in strict confidence. He said that last July while he was having dinner one night with the Chiang Kai-sheks along with Mall Petch and others of his Mission, Madame asked him to step outside and speak to the Generalissimo alone for a minute. She warned him to listen carefully to what the Generalissimo said as he had rehearsed it and that she had never before known him to make such a statement to a foreigner.

18. Chiang Kai-shek had commenced (speaking in short sentences, whereas he usually is hard to interpret because of his length) by saying that he had known several British Ambassadors. He spoke well of Lamson, whom he had liked. Cadogan he had also liked although he found him less sympathetic and lacking in imagination. Knatchbull-Hugessan he had not cared for so much. But he, Clark Kerr, the Generalissimo had found by far the most understanding of them all. Chiang Kai-shek therefore desired to know if Clark Kerr would be willing at times to put aside his official rank and advise him on matters as he might request. Clark Kerr said he himself uttered a lot of deprecatory sputtering during this effusive outburst by the Generalissimo and assured him he would be most glad to comply with the request. As they walked out Madame Chiang again impressed upon him how absolutely unique and unusual this action had been on the part of her husband.

19. A few days later the Generalissimo invited him to call and, referring to this incident, said he would like to make his first request. He thereupon asked Clark Kerr if the latter thought the Chinese Government needed reorganizing and, if so, what would he suggest. The Ambassador said he turned to Madame Chiang and asked if he really could reply frankly. She urged him to do so. He then told Chiang Kai-shek that he thought reorganization very seriously needed. He said if he were Chiang Kai-shek his first move would be to call all members of the family to Hankow, included Madame Sun Yat-sen, and to bring the Young Marshal out of retirement. He would then line them up and present a solid front to the Japanese ('have all of them tweak their noses at the Japanese', as he expressed it). He said he thought this would have a drastic result in Japan. He recommended that Dr. Kung be retained as President of the Executive Yuan (remarking aside to me that he did this to save Kung's face, but placed him where he could do no harm). He suggested that Madame Sun be made Minister of Cooperatives or something similar (telling me he purposely included her to take care of the Communist element) and strongly recommended Madame Chiang as Minister of Foreign Affairs. (Although

the foregoing sounds semi-jocular, he related it in all seriousness.)

20. He then went on to recommend to the Generalissimo that he reorganize the entire Government along the lines of the membership of the People's Political Convention (which he said he thought had been very well chosen) and that he pointed out to Chiang Kai-shek the need for placing men according to ability and qualification rather than giving all of the plums to former comrades and old cronies. The Ambassador said his suggestions met with a chilly response and obviously did not meet with the approval of the Generalissimo who remarked that if Madame Sun came to Hankow she would only be a mouthpiece for the Communists. The Ambassador said he had talked with Madame Sun in Hongkong; that he liked her best of the whole family; and that she had expressed her desire to go to Hankow if the Generalissimo would only invite her.

21. The Ambassador promised to show me the despatch he was drafting to the Foreign office concerning the Aide Memoire and readily assented to my request to be permitted to read the Aide Memoire. His copy was at the moment out on the launch. He asked me to return in a day or two to see the despatch, remarking that he actually had no business doing this. He said he had recently proposed that the British, French and U. S. Governments should make separate but as nearly identical as possible declarations affirming their support of China. The French, he stated, had indicated their willingness to do so, but the proposal was frowned on and killed by the U.S.A. He inquired who our present counsellor of Embassy in London was and said he understood this officer had been instrumental in it. The Ambassador termed the attitude of his own government toward the recent situation "contemptible". He said he understood the general limitations which restrained the U.S.A. from taking direct action, but inquired if I knew whether this were further constricted or aggravated by any particular individuals in Washington. I denied any such knowledge. The Ambassador and his party had dinner with the Generalissimo that same evening, but as the party was fairly large, nothing further transpired.

22. The following morning, November 7th, I met Mr. Donald as he was going for a talk with the Ambassador. When I told him I had received permission to see the Aide Memoire, he pulled his copy out of his pocket and loaned it to me while he went to keep his engagement. He likewise conveyed to me an invitation from Madame Chiang to come to lunch the following day. I returned to my quarters at once and made the attached copy of the Aide Memoire.

23. Lunch the next day was a simple family affair served on a card table with only Mr. Donald in addition to the Chiangs. Madame Chiang told me before lunch that the Generalissimo had been told that I was acquainted with what he had said to the British Ambassador. The Generalissimo appeared looking quite fresh and showing no signs of the strain he had exhibited during the latter days at Hankow. I have seen him numerous times in the past so there were no formalities between us.

24. I let him open the conversation and he started by asking me when the new U. S. battleships would be completed and if they would be larger and more numerous than those being built by Japan. He appeared slightly surprised and disappointed when I told him they probably would not be launched until 1942 or 1943. (I had to guess at this as I have been out off from the news a good deal

recently, but did not want to give him any encouragement on this score.) I told him I did not know what Japan's building program is, but that I doubted if they could afford to compete with us. He then asked how much longer President Roosevelt had to serve and seemed to brighten when I told him two years. He asked if the President could be re-elected and nodded pleasantly when I told him there was no legal bar to this. He inquired if I thought public opinion against Japan was growing in the U.S.A. and nodded understandingly when I told him that I thought it was, but added that its development was gradual and that the American public naturally were more interested in their own affairs and were primarily desirous of peace.

25. I then repeated briefly what Clark Kerr had told me of the Generalissimo's military program and inquired if this were essentially correct. He agreed except to amend the part about sixty divisions north of the river and sixty more south thereof. He said that was roughly the present distribution, but that he proposed to use sixty east of the two railway lines, sixty to the west thereof and the balance in reserve under reorganization. He explained that a great many of these divisions had been in the field for several months and that some were now reduced to the strength of only one company. These had to be pulled out for rest and reorganization while others had to be brought up. Other than the mention of the railway lines, he did not mention a front as such, but merely asserted that he intended to keep the Japanese under the constant threat of attack in all areas. He spoke of the guerrilla tactics which had been carried out all of these months and said the Chinese would depend on these rather than sacrifice their strength in trying to hold any particular point. He appeared to me to be very confident in this respect and I believe he is imbued with the experience he had in fighting the Communists for years.

26. I had expected the Generalissimo to ask me questions about what we were going to do to help him and when he failed to do so, I referred to what he had said to the British Ambassador and inquired if I were to infer that this applied with equal force to the U.S.A. He was called away from the table just as I finished putting the question, but as he rose to leave he replied that he thought that had better wait until he could discuss it directly with my Ambassador.

27. I walked for an hour after lunch in the garden with Madame Chiang and Mr. Donald. I asked Madame Chiang for an explanation of the Canton debacle which would explain or refute the assumption of the general public that there had been a "sell-out". She denied vigorously that there had been any bribery. She referred me to the Generalissimo's public statement of October 30th and added that Yu Han-mou had failed to make the proper disposition of his troops because his staff officers and troop leaders were inferior. She mentioned that a statement in regard to this had been included in the Generalissimo's public announcement, but Mr. Donald interrupted to say that "we" (presumably he and Hollington Tong) had cut out that part. She then went on to say that this plus the fact that the British had failed to intervene had produced the present situation, but added that they were now fighting to recover the lost ground and said the Generalissimo had had a telegram just the previous evening that Samsui had been re-captured. She denied that the Japanese had made any progress along the railway north of Canton. She stated that the Generalissimo was receiving hundreds of telegrams from overseas Chinese demanding that China continue to resist Japan and calling for the punishment of Yu Han-mou and Wu Teh-chen. She did not, however, enlarge on the latter point.

28. I asked point-blank how the Generalissimo could adopt the alternative he had mentioned to the British Ambassador of making easy terms with Japan if he would completely renounce the British. I pointed to the widespread feeling against Japan and the fact that the Japanese army exists as a physical enemy and invader. She did not blink an eye, but replied simply that she thought the people would do whatever the Generalissimo told them was best when the time came. I then referred to the 1924-1930 era when the anti-foreign feeling was so high; contrasted it with recent months when the people had been so friendly to foreigners; and asked if officials would take the lead in turning the people against Great Britain in order to make possible a peace treaty with Japan. I added that the comparison of the two periods had led me to believe that public opinion in China could be influenced very easily by officials. She dodged the question by saying that she and the Generalissimo had worked very hard for a long time to bring about a friendly feeling toward foreigners. I asked again about the questions which had been presented to the British Ambassador and inquired if they did not apply with equal force to the U.S.A. She reiterated that any actual statement on the question should await a meeting between the Generalissimo and my Ambassador, but said that we "might well consider the questions asked Great Britain as the handwriting on the wall".

29. I saw the British Ambassador again that afternoon for another long talk. He asked if I had seen the Aide Memoire. When I told him I had, he stated he had radioed all of it to London except the reference to Hainan Island which he thought was superfluous and weakened the argument. He said he did not desire to give London any point on which to quibble. He apologized for not being able to show me his despatch which he said had just gone to the ship to be coded, but told me it followed the lines of what we had discussed the previous time. He handed me from his table another despatch which he had just drafted in which he had outlined briefly the Generalissimo's general attitude and determination to continue resistance.

30. When I referred to the points in the Aide Memoire as an "Ultimatum" he picked me up immediately. He emphasized that there had been no questions of an ultimatum on the part of Chiang Kai-shek during their conversation and that he himself, after reading the Aide Memoire, had sent a second telegram to London to emphasize this. He said that Chiang had put the questions simply as statements of fact to which he desired an immediate answer; that Chiang had stated that he had always desired friendly relations with Great Britain and up to the present had been confident that Great Britain would help China, but that the time had arrived when he had to have something tangible to show the people, if it were only a loan to support the currency. When Chiang had stated that he had "several other courses open" if London failed him, the Ambassador had asked if Russia were one of these. Chiang had silently assented, but had offered no further information on this point. Sir Archibald seemed surprised when I told him that both Madame Chiang and Donald had specifically denied on several occasions that the Russians had ever presented a quid pro quo to the Generalissimo. I mentioned the recent case of the planes at Lanchow and he said that Donald had also told him that.

31. The Ambassador said that he was at a loss to understand his country's attitude; that he could not understand why they fear Japan, especially now when Japan is obviously too weakened even to think of fighting any other country. He said that prior to assuming this post he had asked in the Foreign Office if they could give him any directive as to the policy they wished to pursue out here. He was told that he would have to work it out largely for himself, but that in general they thought the Chinese and Japanese should fight it out among themselves. He again referred to their present position as "contemptible" and said frankly he did

not know how to solve the problem.

32. I had made plans to leave Changsha at once and get to Chungking as soon as possible with my information. The Ambassador had already persuaded the Chinese to send him on to the coast via Nanchang to Foochow. I accompanied him from the above interview to the gunboat where he was greeted with a message from his representative in Chungking urging him to come here to avoid offending the government officials. The Ambassador changed his plans on the spot and, turning to me, inquired if I would like to join his caravan. I accepted because it afforded me an opportunity for further conversation and likewise provided company through the bandit region of eastern Kweichow which people had been advising me to avoid.

33. When I went to the local airport to see him off as he left by private plane for Hongkong on the afternoon of November 19th, he told me he had been receiving urgent messages from Sir Robert Craigie asking for permission to show the Aide Memoire to his American colleague. He said Sir. Robert also had recently changed his tune very decidedly with regard to Japan and that he hoped to draft a message on the plane enroute to Hongkong to get off to London from there and take advantage of this change of heart while it lasted.

34. Mr. Donald informed me just before I left Changsha that they had decided to cable the Aide Memoire to Dr. Hu Shih in Washington, but that they had added an injunction that he was not to show it to anyone until he received permission. Mr. Donald said they had done this to permit me to reach Chungking with it first.

35. I have presented the foregoing in rather exhaustive detail with a double purpose, (1) I desired to give as accurate as possible an account of what actually transpired and was said in order that it could be evaluated in its true perspective, and (2) to bring out my belief that the information was not "cooked up" or "planted" on me by either the British or Chinese. I merely happened to be on the spot when the talks took place and to have had the advantage of prior intimacy with both parties plus an informal status which permitted them to talk freely to me.

### 36. Conclusions

After my arrival in Chungking with the foregoing information our Ambassador requested that I submit to him a Memorandum containing my reactions and opinions concerning the present situation in the light of what I had experienced at Changsha. I append hereto as Enclosure "A" a copy of this memorandum as my conclusions to this report.



OFFICE OF THE NAVAL ATTACHE  
AMERICAN EMBASSY  
CHUNGKING

24 November, 1938.

MEMORANDUM FOR THE AMBASSADOR

Subject: The Conference at Changsha Between the Generalissimo and the British Ambassador and the Interest of the United States in the Situation Resulting Therefrom.

1. Upon first reading the Aide Memoire and talking with Mr. Donald and Madame Chiang thereafter, I gained the impression that Chiang Kai-shek had presented the British with an ultimatum and I so referred to it, as noted in my report, in my second conversation with Sir Archibald. The document contains both the time element in its request for an immediate "Yes" or "No" reply from London and what on first glance appears to be an implied threat in its assertion of there being alternative courses of action if the British fail. In the light of the British Ambassador's subsequent explanation and of further consideration of the situation, however, I believe that Chiang Kai-shek merely confronted the British with a cold assertion of fact and the simple statement that if they do not come to China's aid, China must perforce seek assistance elsewhere.

2. The situation is unquestionably very serious and must be so dealt with. It presents a difficult problem and certainly one not to be brushed aside with a light wave of the hand or a vague hope that 'all will come out all right in the end'. It is true that at the moment we are not as much "on the spot" as the British, for we are not a member of the League of Nations, we have made tangible efforts at granting some kind of financial assistance to China through the purchase of their silver and the recent negotiations with the K. P. Chen Mission, and our note to Japan of October 8th has been very favorably received by the Chinese. The British are committed to specific courses of action which they are not implementing; they have hinted at loans they are not producing; and they are maintaining a strange silence toward the preempting by Japan of large commercial interests through which they once dominated the trade of the Far East. More than this, they have actually negotiated with the Japanese on at least two occasions; the Customs Agreement and the British American (Yee Teong) tobacco interests.

3. But in the sense that we are the leading democracy of the world and stand for announced principles which have been contravened right and left ever since the invasion of Manchuria in 1931; that it has been possible for Japan to obtain important war materials from us; that we have a large cultural stake in China which is in danger of being swept away, we too are "on the spot". It is my firm belief, therefore, that if China turns against Great Britain, we shall ultimately share the same fate unless we produce more tangible assistance to China, and do it in the near future.

4. The problem of the moment can be stated very simply: China is fighting for her life, for her independence as a nation. Japan has declared her purpose on more than one occasion of dominating not only China, but the whole of the Far East; of creating an "Asia for the Asiatics".

5. What do we want, China or Japan?

6. The situation of the moment, as I see it, is as follows: China has been fighting a losing battle for sixteen months, confident that sooner or later the democracies must come to her assistance. The failure of the British even to make a statement, much less take any action when Japan occupied Canton and cut off Hong-kong, came as a cruel blow and rude awakening to the Chinese. They have therefore asked the British, 'Are you going to help us or not? Are you even going to stand up for your own interests? If not, we must know it now and adopt some other policy.' China has now reached the point where she is almost completely cut off from supplies and has only enough remaining to carry on the fight a few months longer. She cannot wait until the moment of total exhaustion comes to make her decision.

7. Our problem has to be analyzed from the two angles as stated. Do we want a strong, stable, peaceful and independent China, or do we want an Asia dominated by Japan?

8. The Japanese program is clearly one of driving us and our institutions out of Asia. Any attempt to minimize this, to regard it as temporary, to apologize for it, to seek hope in the fact that a portion of the Japanese people may have been unsympathetic with this war or to argue that our trade with Japan has been far more valuable to us than our trade with China is short-sighted and evasive to say the least. Let the ultimate goal of the Japanese be clearly understood from the first, for it is cold and simple fact, regardless of what friends of Japan may argue.

9. That the Japanese army may utilize the aid of the Germans or other totalitarian states for a time during the process of achieving this domination constitutes no saving clause for us. Any benefit which either we or the British may derive through the Japanese in the post-war economic rehabilitation period of the present conflict, even if they emerge only semi-victorious, will be temporary exactly in proportion to the degree of their victory and the period of time it takes them to reach the point where they feel strong enough to kick us out. Any attempt to assume greater hope than this is totally unwarranted in the face of what has already transpired. They are arrogant, truculent and their promises to us are wholly unreliable. No statement that they make to us is worth the paper upon which it is written or the breath required to utter it unless it be one of those not infrequent occasions when they let slip their real purpose. Anyone who may think his future is safe in their hands is taking a very long chance.

10. The extent of the victory which they may achieve from their present venture is problematical. I have felt from the outset of this war, as I have stated in previous reports, that they were walking into a swamp; that there are not enough Japanese in Japan to patrol and police this vast country with its millions of people; and that eventually the Chinese will suffocate them or rise and massacre them as they did the Manchus after 250 years under their rule. But the long point of view offers little solace and no solution to our own immediate problem.

11. It has recently been suggested by a competent authority on Japan that the Japanese do not intend to attempt the "pacification" of all China; that they propose to sit down on what they have, open and maintain the lines of communication, establish trading outposts as one would do in darkest Africa; and let the Chinese "stew in their own juice" back in the interior. It is this lesser goal, with the possibilities presented if the Japanese obtain the cooperation of the Germans and their barter system, which gives food for thought and is a problem worthy of serious consideration. What its possibilities are we do not know. But what we do know is that it will exclude us and slam our "Open Door" in our face.

12. Let it not be forgotten also that the present attempt at conquest on the mainland of Asia is the Japanese Army program and that the Japanese Navy still has to be heard from. They have had very little part in this war to date. The Navy program has long been known to advocate expansion toward the South Seas. China is, in reality, a great big farm and does not possess anything like the wealth of undeveloped resources that many writers have claimed. But to the south lie the Malay Peninsula and the Dutch East Indies with their known wealth of rubber, tin, oil and other resources. Will Japan ignore these if she succeeds in China?

13. In our present efforts to establish reciprocal trade agreements with free nations throughout the world, which may lead eventually to unrestricted trade among democratic nations, we have our most potent weapon for an ultimate solution. But again this is not a solution for the present crisis. Should we, can we sit idly by and watch the world's next biggest democracy and one of the most potential areas for the extension of this policy co-opted and stifled by Japan and her allies and closed to our commerce simply because that nation is still too cumbersome and lacking in munitions and supplies to take care of itself?

14. Thus far we have given the Chinese almost nothing but moral support in this war while affording the Japanese the materials for war. That we have done this latter not intentionally but merely in pursuance of our own "open door" policy to any purchaser who has the money with which to buy is not a satisfactory reason considering the result it is producing for us in Asia and the prospects for the door which we hope to keep open there.

15. The second angle of the problem is the Chinese side. In my questions to Madame Chiang I indicated my apprehension that the Chinese might be aroused against us by inflammatory speeches in order to pave the way for peace with Japan. But it has since been suggested to me, and it is very plausible, that if we continue our policy of non-interference and fail to supply them with tangible evidence of our good will, they may automatically turn against us. There is no reason why they shouldn't. They are a nation fighting for their life and, as the British have been told, if the democracies do not help them, they naturally must turn to those who will.

16. As I stated in a recent despatch, I believe this feeling would easily arise and would be very difficult to combat. I lived in China during the period of intense anti-foreign feeling from 1924 onward, when whole cities burst into flames of hatred overnight and illiterate coolies mouthed slogans against the foreigner; when every Chinese eye had a baleful glint in it as a foreigner passed; and when laborers, dock workers, factory employees and servants staged "go-slow" strikes, "sit-down" strikes and outright strikes accompanied by the most fantastic demands long before the C.I.O. over thought of these devices.



17. I have been very favorably impressed during recent years, and especially during the one just passed, with the generally friendly attitude displayed toward us. It is true that since the outbreak of the present war foreigners living in China have been on common ground with the Chinese in hating the Japanese and that this has greatly enhanced the feeling of friendliness on the part of the Chinese toward foreigners. But I have been apprehensive for a long time that the day might come when they might turn up with the cry that we had failed them, for the Chinese are past masters in the art of alibi and will never accept the blame for the loss of the war themselves. Individually they have never wanted the war from its very beginning. They are a peace-loving people and they have constantly hoped that someone else would come along and fight it for them. Had this third party appeared, they would have tossed him the baby forthwith and let him carry it. The Chinese aviators have already demonstrated this on several occasions, both with the Russians and the "Foreign Legion" 14th Squadron. But the Chinese had to fight this war alone in order to achieve any degree of unity and they have already derived immeasurable benefit from it in this respect.

18. I remarked in my report No. 1-38 last January that I thought an ideal result for this war would be for it to go on long enough to burn the corruption and venality out of Chinese official life and at the same time to break the hold of the Japanese army on the national life of Japan. That the Chinese and Japanese should fight it out between themselves has unquestionably been the point of view of many people and this has been correct up to a point. But as one who has been in the thick of the war almost from its beginning and who has travelled rather extensively through the country in recent months, it is my considered opinion that we have reached the point where we no longer can leave the outcome to chance. Some people may sit back and say complacently that the Chinese will never be able to do without the U.S.A. either economically or politically, but personally I am not so sure.

19. Furthermore I believe that if feeling starts against us it can be fanned into flames very quickly by "soap box" orators and radio broadcasters on the charge that we let them down. The cry may start against the British who are far more culpable and vulnerable than we for we made no promises and we are not a League member. Our position and our reasons for not helping have been perfectly clear to us; they have been nothing like that clear to the Chinese. And if a hue and cry should start against the British, there would be little differentiating done by the Chinese masses between British and Americans. It may be said that the British were specific targets in Shanghai, Canton and Hongkong in 1925 and 1926 and that we did not suffer as much in comparison, but those were specific areas where the target could be identified. Such was not the case in other parts of China, as residents of Changsha, for example, will testify, and such will not be the case this time if it comes.

20. I have emphasized the potential turn of feeling against us to bring out one point: that irrespective of the outcome of this war, the recent conferences at Changsha impressed me particularly with one fact -- namely that we are faced with the immediate question of retaining China's good will. Whether the war ends in a stalemate with neither side winning, or Japan wins, or China compromises with Japan, we have this question to answer now. We have 154 years of cultural effort behind us in China. Almost every other member of the present government is American educated. But our pupils are the ones who will be most disappointed, and in many

cases disillusioned, if we fail them now.

21. The main question, however, still is: Do we want a strong and independent China, or one dominated by Japan? The immediate problem is, Will we act to preserve China's good will while we still retain it? The answer to the latter will largely constitute the answer to the former. It hardly needs saying that if Japan achieves any marked degree of success in this venture, we shall have to build a navy several times as large as the one we now contemplate. The best insurance we can obtain for peace and for the further development of our trade program is a strong, independent, peaceful and friendly China together with a chastened, not a ruined Japan. The only hope of achieving that, I believe, is to retain the good will of the Chinese before it is too late.

22. The present Government of China, despite its many shortcomings, is the only one in recent years that has ever done anything for the people. It has represented that which we regard as rational and that with which we have some chance of doing business along the lines we desire and in accordance with the principles for which we stand. It was achieving steady progress in the development of China before this war commenced. There is bound to be chaos and disorder for a time after this war, whoever wins. Let there be no mistake about that. But the support of Chiang Kai-shek and his government offers by far the most hope for a solution of this chaos and a return to normalcy in the minimum possible time.

23. It is not a question of the Kuomintang versus the Eighth Route Army and which set of principles should guide the government of China. That is something for the Chinese to work out for themselves after the Japanese have been pulled off of their backs. In that respect our interest again lies in maintaining the friendship of the Chinese and in influencing them thereby to adopt orderly processes of government in harmony with those for which we stand. It need only be remarked in passing that the so-called Communist Party continue to support the Central Government with apparent sincerity; that they have again refrained at the recent People's Political Convention from endorsing any resolution critical of the Government; that they still profess unbending opposition to Japan (which is probably the best assurance available to any who may fear a sudden Chinese compromise with Japan); and that they show signs of developing into a democratic or popular party rather than communists as we think of the term. If this trend continues, they will provide China after the war with the healthy political opposition which any democracy needs and thereby force the elimination of the undesirable and corrupt elements in the Kuomintang.

24. There are many people in the U.S.A., and among them some officials, who appear to think that there is no ground between war and full retreat. It has been my conviction for a long time that there is a very wide stretch in there and that in it lies the means to peace through firmness and dignity. We have got to do more than voice our principles and write notes about them. We have got to insist step by step that they be recognized and respected. In a world which is relying on force we cannot possibly hope to survive by lip service to altruism. We must utilize our tremendous potentiality, both economically and financially in support of the principles for which we stand.

25. Nor can this be accomplished through a policy of indirection. It must be a studied program in which pressure is applied step by step with the will to fight if necessary as the last move. This is the point that our people must come to realize -- that we cannot run away from war or leave it until some vague future date when we might be invaded. When the time arrives, if it ever does, that any foreign power or combination thereof feels strong enough to attempt to invade the U.S.A., it will probably be too late for us to resist effectively. But the United States can be invaded in more ways than by an army. The influx of cheap Japanese products in recent years and its harmful effect on our labor situation was a case in point.

26. I have watched the Japanese ever since they invaded Manchuria in 1931. They have proceeded step by step - phase by phase - looking back over their shoulders at us after each move. When we failed to do more than protest, they proceeded with the next move and have grown increasingly bolder. I am convinced they can be stopped by firmness, by a progressive program of pressure, backed by the will to fight if necessary as a last resort. It will be this realization by them of that determination on our part which will stop them.

27. There are many ways and means to apply this pressure. We have already intimated retaliation in kind in our note of October 8th. It is to be hoped that we take steps to implement it. For immediate use there is the elastic tariff scale and I believe its use thoroughly justified immediately in respect to situations such as now exist at Tsingtao and other North China ports in the manipulation by the Japanese of their Federated Bank currency in discrimination against our merchants. Further and more drastic steps will have to be authorized by legislation and our every move should be directed toward obtaining what we need in this respect.

28. Ours is no longer a question of pulling the British chestnuts out of the fire. The time has come when we must act to save our own, for they are already scorching. If we save theirs for them in the process, that will be their good fortune -- and possibly not such an unfortunate result for us at that!

Respectfully submitted,

J. M. McHugh  
Captain, U.S.N.C.  
Assistant Naval Attache.

C O N F I D E N T I A L

AIDE MEMOIRE OF CONVERSATION BETWEEN THE GENERALISSIMO  
AND SIR ARCHIBALD CLARK KERR ON NOVEMBER FOURTH, 1938.

(Verbatim Copy)  
(Enclosure B to Report No. 10-38, dated 20 Nov. 1938)

The Japanese occupied Canton with two motives in mind. The first is the effect of such occupation upon China, and the second is the effect upon Great Britain. To strike at China is of secondary importance while to strike at Great Britain is of major importance. By occupying Canton, Japan only cuts the Canton-Hankow Railway and blockades the waterways impeding transportation and stopping supplies of munitions. Canton, too, is an important base for national resistance, and Japan hopes by its occupation to break down the morale of the Chinese people. However, the cost of landing and maintaining her forces there will not be compensated by the above results alone. But in striking a death blow at Britain's historical prestige and traditional morale, she immeasurably enhances her own position and value. The present blow to Great Britain is not as great in effect as it will be in the future. Japan hopes that just as Britain's power and prestige suffer in South China, hers will rise proportionately in the eyes of the Chinese and all Asiatic peoples.

Thus she hopes to occupy completely the historical place formerly enjoyed by Great Britain during the last hundred years as the dominant factor in Far Eastern affairs.

By the successful occupation of Canton, Japan hopes that the old reliance of China upon Great Britain will now be abandoned in favor of Japan. Japan thinks that if she can break down British influence in South China she can break it down elsewhere. And the British Government and people may well ponder what the answer will be.

What I want to know is, "What will be Great Britain's Far Eastern policy in view of this latest move on Japan's part?"

Will Great Britain view the occupation of Canton in the same light as she viewed the occupation of Manchuria, North China and Shanghai?

Moreover, what will Great Britain do in view of this latest development?

I would like to have a definite answer to this question.

In view of the fact that Great Britain's interests and prestige are threatened, will she quietly accept this fait accompli or will she demonstrate in no unmitigated terms her real intentions unequivocally, to safeguard her economic and political interests in the Far East, and, above all, to follow her historical policy of upholding high principles to which she has committed herself, or will she abandon these principles and sacrifice her standing?

China has been fighting lone-handedly for the past sixteen months. We have looked to Great Britain and hoped for help, but up to the present we have received nothing tangible. We appreciate that we secured munitions through Hong Kong, and upon a mutually advantageous basis, but that avenue has now been closed.

As long as South China was not attacked, we made allowances for Britain's hesitancy to extend practical aid to us, but now that Japan has cut off British trade there is no reason why Britain should hesitate to extend help to us.

As time goes on, our people and the Chinese army will become more and more disappointed in view of the absolute lack of concrete and tangible evidence of British support. And that is something which the Chinese Government will be constrained to take into account.

I would, therefore, like to know whether Great Britain will adhere to her obligations as a member of the League of Nations, live up to her historical and traditional standards, and extend economic or some other practical help to China?

I would like to have this answered in a definite "Yes" or "No".

For the past sixteen months we have been hearing a lot of discussion about loans, and we have been put off from time to time with excuses that loans were impossible because of Parliamentary complications. But the whole world witnessed the granting almost overnight to Czechoslovakia of a loan similar in nature to that asked for by China.

Now the moment has come when we must have definite knowledge of Great Britain's intentions.

If Great Britain turns her back alike upon us and her principles, then I shall never bring up this question again. Nor shall I ever mention anything concerning Great Britain's Far Eastern policy. Nor shall I consult Great Britain as to China's future policy or attitude, or anything concerning the Far East.

I can hardly believe, however, that an Empire which produced such statesmen as Disraeli and Gladstone could fail to see the significance of the repercussions of the occupation of Canton, and the inactivity of Great Britain upon her future in the whole of Asia.

This is the life and death turning point in British Far Eastern policy. Whether Britain extends aid to us or not - the British Government should realize that China today is unified as never before, and that we are determined to carry on prolonged resistance. Japan is unquestionably striving to have peace, on terms, however, not beneficial to Great Britain, and thus excluding her from Asiatic affairs. Japan would be willing to concede the gains she has acquired since hostilities began. If that question comes up, what is China's answer going to be?

If Japan wins the war, the old and outstanding interests of Great Britain in China will be finished.

We must know what Great Britain's answer is to be, because upon it depends the future policy of the Chinese Government. There are several roads open to us.

One thing that must be kept in view is that Japan, having occupied Canton, will probably occupy Hainan Island. What such a move will pretend to Hong Kong can be left to the imagination.

In view of the importance of the questions raised in this conversation, will you kindly communicate immediately with the British Government and let us have a reply?



November 21, 1938

My dear Mr. President:

Sunday night, at my house, I had a most interesting discussion with Dr. Isaiah Bowman on colonies.

Dr. Bowman secured for me the information contained in the attached telegram. You will note that the only country in Central America which offers possibilities for colonization is Costa Rica. I am securing maps of Costa Rica and as soon as I have them I will send them down to you. I would also like to remind you that it is Costa Rica that Mr. Zemmurray, of the United Fruit, informed you (and Jeff Coolidge informed me) is in need of \$5,000,000 to put them on their feet financially.

Dr. Bowman left with me a map which he has prepared, at your request, covering the countries south of the Rio Orinoco. I am forwarding it to you.

He is also going to give me a memorandum on possible locations for colonization in South America.

At my suggestion, he has retained an assistant who is an expert on the colonies in South Africa and as soon as he has a report I will advise you.

Have you any suggestions as to how we should proceed in regard to Costa Rica?

Yours sincerely,

The President,

Warm Springs, Georgia.

November 21, 1938

My dear Mr. President:

Sunday night, at my house, I had a most interesting discussion with Dr. Isaiah Bowman on colonies.

Dr. Bowman secured for me the information contained in the attached telegram. You will note that the only country in Central America which offers possibilities for colonization is Costa Rica. I am securing maps of Costa Rica and as soon as I have them I will send them down to you. I would also like to remind you that it is Costa Rica that Mr. Zerrway, of the United Fruit, informed you (and Jeff Coolidge informed me) is in need of \$5,000,000 to put them on their feet financially.

Dr. Bowman left with me a map which he has prepared, at your request, covering the countries south of the Rio Orinoco. I am forwarding it to you.

He is also going to give me a memorandum on possible locations for colonization in South America.

At my suggestion, he has retained an assistant who is an expert on the colonies in South Africa and as soon as he has a report I will advise you.

Have you any suggestions as to how we should proceed in regard to Costa Rica?

Yours sincerely,

The President,

Warm Springs, Georgia.

November 21, 1938

My dear Mr. President:

Sunday night, at my house, I had a most interesting discussion with Dr. Isaiah Bowman on colonies.

Dr. Bowman secured for me the information contained in the attached telegram. You will note that the only country in Central America which offers possibilities for colonization is Costa Rica. I am securing maps of Costa Rica and as soon as I have them I will send them down to you. I would also like to remind you that it is Costa Rica that Mr. Zerrurray, of the United Fruit, informed you (and Jeff Coolidge informed me) is in need of \$5,000,000 to put them on their feet financially.

Dr. Bowman left with me a map which he has prepared, at your request, covering the countries south of the Rio Orinoco. I am forwarding it to you.

He is also going to give me a memorandum on possible locations for colonization in South America.

At my suggestion, he has retained an assistant who is an expert on the colonies in South Africa and as soon as he has a report I will advise you.

Have you any suggestions as to how we should proceed in regard to Costa Rica?

Yours sincerely,

The President,  
Warm Springs, Georgia.

COPY

WESTERN UNION

CAL4 811 NL COLLECT 7 EXTRA 1/141 - SANTAMONICA CALIF 19  
DR ISAIAH BOWMAN  
OAK PL BALTO

THE FOLLOWING STATEMENT PREPARED AFTER CONSULTATION WITH MY COLLEAGUES DOCTORS FITZGIBON POLITICAL SCIENCE AND HUSSEY HISTORY BOTH OF WHOM SPENT RECENT MONTHS IN CENTRAL AMERICA. THIS SUMMARIZES OPPORTUNITIES FOR AGRICULTURAL COLONIES. INDUSTRIAL AND COMMERCIAL OPENINGS FOR LIMITED NUMBER MIGHT BE EXPECTED IN TIME. WAGES FOR AGRICULTURAL AND INDUSTRIAL LABOR EXTREMELY LOW IN ALL SECTIONS. ROAD SYSTEMS BEING ACTIVELY EXTENDED IN MOST COUNTRIES AND AIR SERVICE MAKES MANY REGIONS NEWLY ACCESSABLE.

COSTARICA OFFERS BEST POSSIBILITIES FOR SEVERAL 10,000 GROUPS. COUNTRY DEMOCRATIC AND SYMPATHETIC TOWARD IMMIGRATION. UPPER RIM OF MESETA CENTRAL AND UPPER SLOPES BEYOND THAT RIM CONTAIN FERTILE VOLCANIC SOIL WELL DRAINED EASILY CLEARED AT ELEVATION OF 3,000 TO 6,000 FEET. WHILE LOWER ELEVATIONS OF MESETA ARE THICKLY PEOPLED HIGHER ELEVATIONS ARE SPARSELY INHABITED. DISTANCE TO MARKET NOT GREAT OVER FAIR ROADS RAPIDLY BEING IMPROVED. CLIMATE EXCELLENT. WESTWARD SLOPE TOWARD NICARAGUA ALSO SPARSELY

- 2 -

CALA 2/160

INHABITED AND ABOVE 3,000 FEET OFFERS POSSIBILITIES PARTICULARLY ABOUT HEADWATERS OF SANCARLOS AND ON PACIFICWARD SLOPE. PENINSULA OF NICOYA ALSO OFFERS POSSIBILITIES AS DOES RATHER ROUGH MOUNTAIN TERRAIN OF TALAMANCA CORDILLERA. MOST OF REGIONS MENTIONED ARE SUITABLE FOR CEREALS BEANS AND FRUITS FOR SUBSISTANCE AGRICULTURE AND COFFEE FOR EXPORT. THIS COUNTRY PARTICULARLY ATTRACTIVE BECAUSE POPULATION IS MOSTLY WHITE.

HONDURAS. MOST OF HIGHLAND 3,000 TO 5,000 FEET ELEVATION CONTAINS SPARSE POPULATION. THE SOIL IS GOOD THE RAIN VARIES FROM 30 - 50 INCHES RESULTING IN A GOOD GROWTH OF VEGETATION AND EXCELLENT FORESTS OVER MUCH OF THE AREA. LONG DRY SEASON FROM NOVEMBER TO APRIL OFFERS A PROBLEM AND HAS HELPED TO KEEP AGRICULTURAL DEVELOPMENT DOWN BUT SHOULD NOT PREVENT EXTENSIVE PROFITABLE GRAIN FARMING IF ROADS ARE CONSTRUCTED AS OUTLETS TO MARKET THOUGH INTENSIVE AGRICULTURE MAY NEVER BE POSSIBLE. A MUCH LARGER ANIMAL POPULATION SHOULD BE POSSIBLE ALSO WITH INTELLIGENT MEASURES AGAINST TICKS WHICH NOW CONSTITUTE A SERIOUS HANDICAP.

- 3 -

CAL4 3/160

MINING TOO OFFERS GOOD POSSIBILITIES KNOWN DEPOSITS OF GOLD AND SILVER BEING NUMEROUS. THESE AREAS ARE SUITABLE FOR PIONEER SETTLEMENTS AND WITH FURTHER EXTENSION OF ROADS AND RAILROADS SHOULD SUPPORT MANY 10,000 GROUPS. PINE LUMBERING INDUSTRY ALSO PROMISING. ATTITUDE OF GOVERNMENT TOWARD IMMIGRATION DOUBTFUL.

NICARAGUA. UPLANDS FROM MATA GALPA TO UPPER SEGOVIA REGION SPARSELY INHABITED BUT CAPABLE OF SUSTAINING TWO OR THREE 10,000 GROUPS BY SUBSISTANCE AGRICULTURE, TROPICAL AND SUBTROPICAL HORTICULTURE, AND COFFEE PRODUCING FOR EXPORT IF MARKET EXISTS. ROADS FROM MANAGUA AND TO ATLANTIC COAST RIVERS BEING IMPROVED.

GUATEMALA. TWO REGIONS OFFER GOOD PROSPECTS. HIGHLANDS OF ALTA VERA PAZ 3,000 to 4,000 FEET ELEVATION HAVE HEALTHFUL CLIMATE, RICH SOIL, ABUNDANT VEGETATION; HEAVY RAINS, BUT WITH GOOD DRAINAGE DUE TO UNDERLYING LIMESTONE. ROAD SYSTEM UNDER CONSTRUCTION; RAILWAY AND RIVER OUTLET TO LIVINGSTON; AIR LINE TO GUATEMALA CITY. ANOTHER REGION IS HIGHER PART OF WESTERN END PACIFIC COASTAL PLAIN EAST AND WEST FROM COATEPEQUE AND ALONG FOOT OF VOLCANIC RANGE

- 4 -

CALA 4/178

EASTWARD FROM THERE. THIS IS PIEDMONT SLOPE ABOUT 1,000 FEET HIGHER THAN NEIGHBORING UNITED FRUIT COMPANY BANANA REGION, WELL DRAINED VOLCANIC SOIL SUFFICIENT RAINFALL AND EXCELLENT WATER SUPPLY. SOME DANGER OF MALARIA. GOOD FOR CATTLE, SUGAR CANE, CORN, BEANS, TROPICAL AND SUBTROPICAL FRUITS. ROADS LEAD TO GUATEMALAN HIGHLANDS AND RAILROADS TO PORTS OF OCOS AND CHAMPERICO. PRESUMABLY THE PETEN REGION THOUGH ONCE OCCUPIED BY POPULOUS MAYAN CITIES IS IMPOSSIBLE NOW UNLESS AN EXTENSIVE PROGRAM OF MALARIA ERADICATION COULD BE CARRIED OUT. THE TWO RECOMMENDED GUATEMALAN REGIONS ALREADY CONTAIN MANY GERMAN FINCAS, MAINLY COFFEE FARMS, ALSO SOME INFLUENTIAL ENGLISH AND AMERICAN FARM OWNERS. SUBTROPICAL HORTICULTURE AS YET UNEXPLOITED BUT PROMISING. GOVERNMENT LIKELY TO FAVOR IMMIGRANTS, BUT SOME FOREIGN LAND OWNERS LIKELY TO OPPOSE. IN BOTH REGIONS IMMIGRANTS MIGHT BETTER BE SCATTERED THAN CONCENTRATED IN COMPACT COLONIES. AVAILABLE LANDS OCCUR IN LIMITED TRACTS.

BRITISH HONDURAS. (BELICE) INTERIOR HILL COUNTRY OF THE SOUTH WOULD SEEM TO OFFER PLACE FOR MANY SETTLERS IN COUNTRY BETTER THAN IN BELICE WHERE OVER 1,000 WHITES ALREADY LIVE. THIS WOULD STRENGTHEN BRITAIN'S HOLD ON THE TERRITORY

- 5 -

CAL 5/172

PANAMA. THE PACIFIC SLOPE WESTWARD FROM THE CANAL TO THE COSTARICA BORDER WOULD SEEM TO OFFER ROOM AND SUITABLE CONDITIONS FOR SEVERAL 10,000 GROUPS. ISOLATED VALLEYS WITHIN THE CRIQUII MOUNTAINS ALSO OFFER LIMITED SITES AT ELEVATIONS OF 1,000 TO 2,000 FEET. THE COASTAL PLAINS ARE SPARSELY INHABITED AND THE FOOTHILLS LARGELY UNDEVELOPED. THE REGION IS DRY ENOUGH FOR HEALTHFUL LIVING, BUT WITH SUFFICIENT RAIN FOR PASTURE, CEREAL CULTIVATION AND FRUIT GROWING. ACCESS TO PORTS IS EASY AND A ROAD FROM THE CANAL REACHES TO BEYOND DAVID.

SALVADOR. THIS COUNTRY PROBABLY OFFERS NO POSSIBILITIES DUE TO DENSE POPULATION AND INTENSIVE DEVELOPMENT. GENERAL CONSIDERATIONS.

HUMID LOWLANDS HAVE NOT BEEN SUGGESTED BECAUSE OF UNSUITABLE HEALTH CONDITIONS. EACH OF THE SEVERAL COUNTRIES COULD PROBABLY ABSORB A LIMITED NUMBER OF INDIVIDUALS PARTICULARLY OF THE PROFESSIONAL CLASSES AND THOSE FINANCIALLY ABLE AND PREPARED TO UNDERTAKE INDUSTRIAL OR HORTICULTURAL ENTERPRISES. WE WOULD STRESS SUBTROPICAL HORTICULTURE FOR COLONY ACTIVITY, AS YET UNTRIED ON LARGE SCALE BUT EVERYWHERE SUCCESSFUL ON A SMALL SCALE.

GEORGE M MCBRIDE 710 VIA DE LA PAZ  
PACIFIC PALISADES CALIF.



COPY

WESTERN UNION

CAL4 811 NL COLLECT 7 EXTRA 1/141 - SANTAMONICA CALIF 19  
DR ISAIAH BOWMAN  
OAK PL BALTO

THE FOLLOWING STATEMENT PREPARED AFTER CONSULTATION WITH MY COLLEAGUES DOCTORS FITZGIBON POLITICAL SCIENCE AND HUSSEY HISTORY BOTH OF WHOM SPENT RECENT MONTHS IN CENTRAL AMERICA. THIS SUMMARIZES OPPORTUNITIES FOR AGRICULTURAL COLONIES. INDUSTRIAL AND COMMERCIAL OPENINGS FOR LIMITED NUMBER MIGHT BE EXPECTED IN TIME. WAGES FOR AGRICULTURAL AND INDUSTRIAL LABOR EXTREMELY LOW IN ALL SECTIONS. ROAD SYSTEMS BEING ACTIVELY EXTENDED IN MOST COUNTRIES AND AIR SERVICE MAKES MANY REGIONS NEWLY ACCESSABLE.

COSTARICA OFFERS BEST POSSIBILITIES FOR SEVERAL 10,000 GROUPS. COUNTRY DEMOCRATIC AND SYMPATHETIC TOWARD IMMIGRATION. UPPER RIM OF MESETA CENTRAL AND UPPER SLOPES BEYOND THAT RIM CONTAIN FERTILE VOLCANIC SOIL WELL DRAINED EASILY CLEARED AT ELEVATION OF 3,000 to 6,000 FEET. WHILE LOWER ELEVATIONS OF MESETA ARE THICKLY PEOPLED HIGHER ELEVATIONS ARE SPARSELY INHABITED. DISTANCE TO MARKET NOT GREAT OVER FAIR ROADS RAPIDLY BEING IMPROVED. CLIMATE EXCELLENT. WESTWARD SLOPE TOWARD NICARAGUA ALSO SPARSELY

CAL4 2/160

INHABITED AND ABOVE 3,000 FEET OFFERS POSSIBILITIES PARTICULARLY ABOUT HEADWATERS OF SAN CARLOS AND ON PACIFICWARD SLOPE. PENINSULA OF NICOYA ALSO OFFERS POSSIBILITIES AS DOES RATHER ROUGH MOUNTAIN TERRAIN OF TALAMANCA CORDILLERA. MOST OF REGIONS MENTIONED ARE SUITABLE FOR CEREALS BEANS AND FRUITS FOR SUBSISTANCE AGRICULTURE AND COFFEE FOR EXPORT. THIS COUNTRY PARTICULARLY ATTRACTIVE BECAUSE POPULATION IS MOSTLY WHITE.

HONDURAS. MOST OF HIGHLAND 3,000 TO 5,000 FEET ELEVATION CONTAINS SPARSE POPULATION. THE SOIL IS GOOD THE RAIN VARIES FROM 30 - 50 INCHES RESULTING IN A GOOD GROWTH OF VEGETATION AND EXCELLENT FORESTS OVER MUCH OF THE AREA. LONG DRY SEASON FROM NOVEMBER TO APRIL OFFERS A PROBLEM AND HAS HELPED TO KEEP AGRICULTURAL DEVELOPMENT DOWN BUT SHOULD NOT PREVENT EXTENSIVE PROFITABLE GRAIN FARMING IF ROADS ARE CONSTRUCTED AS OUTLETS TO MARKET THOUGH INTENSIVE AGRICULTURE MAY NEVER BE POSSIBLE. A MUCH LARGER ANIMAL POPULATION SHOULD BE POSSIBLE ALSO WITH INTELLIGENT MEASURES AGAINST TICKS WHICH NOW CONSTITUTE A SERIOUS HANDICAP.

- 3 -

CAL4 3/160

MINING TOO OFFERS GOOD POSSIBILITIES KNOWN DEPOSITS OF GOLD AND SILVER BEING NUMEROUS. THESE AREAS ARE SUITABLE FOR PIONEER SETTLEMENTS AND WITH FURTHER EXTENSION OF ROADS AND RAILROADS SHOULD SUPPORT MANY 10,000 GROUPS. PINE LUMBERING INDUSTRY ALSO PROMISING. ATTITUDE OF GOVERNMENT TOWARD IMMIGRATION DOUBTFUL.

NICARAGUA. UPLANDS FROM MATAGALPA TO UPPER SEGOVIA REGION SPARSELY INHABITED BUT CAPABLE OF SUSTAINING TWO OR THREE 10,000 GROUPS BY SUBSISTANCE AGRICULTURE, TROPICAL AND SUBTROPICAL HORTICULTURE, AND COFFEE PRODUCING FOR EXPORT IF MARKET EXISTS. ROADS FROM MANAGUA AND TO ATLANTIC COAST RIVERS BEING IMPROVED.

GUATEMALA. TWO REGIONS OFFER GOOD PROSPECTS. HIGHLANDS OF ALTA VERA PAZ 3,000 to 4,000 FEET ELEVATION HAVE HEALTHFUL CLIMATE, RICH SOIL, ABUNDANT VEGETATION; HEAVY RAINS, BUT WITH GOOD DRAINAGE DUE TO UNDERLYING LIMESTONE. ROAD SYSTEM UNDER CONSTRUCTION; RAILWAY AND RIVER OUTLET TO LIVINGSTON; AIR LINE TO GUATEMALA CITY. ANOTHER REGION IS HIGHER PART OF WESTERN END PACIFIC COASTAL PLAIN EAST AND WEST FROM COATEPEQUE AND ALONG FOOT OF VOLCANIC RANGE

- 4 -

CALA 4/178

EASTWARD FROM THERE. THIS IS PIEDMONT SLOPE ABOUT 1,000 FEET HIGHER THAN NEIGHBORING UNITED FRUIT COMPANY BANANA REGION, WELL DRAINED VOLCANIC SOIL SUFFICIENT RAINFALL AND EXCELLENT WATER SUPPLY. SOME DANGER OF MALARIA. GOOD FOR CATTLE, SUGAR CANE, CORN, BEANS, TROPICAL AND SUBTROPICAL FRUITS. ROADS LEAD TO GUATEMALAN HIGHLANDS AND RAILROADS TO PORTS OF OCOS AND CHAMPERICO. PRESUMABLY THE PETEN REGION THOUGH ONCE OCCUPIED BY POPULOUS MAYAN CITIES IS IMPOSSIBLE NOW UNLESS AN EXTENSIVE PROGRAM OF MALARIA ERADICATION COULD BE CARRIED OUT. THE TWO RECOMMENDED GUATEMALAN REGIONS ALREADY CONTAIN MANY GERMAN FINCAS, MAINLY COFFEE FARMS, ALSO SOME INFLUENTIAL ENGLISH AND AMERICAN FARM OWNERS. SUBTROPICAL HORTICULTURE AS YET UNEXPLOITED BUT PROMISING. GOVERNMENT LIKELY TO FAVOR IMMIGRANTS, BUT SOME FOREIGN LAND OWNERS LIKELY TO OPPOSE. IN BOTH REGIONS IMMIGRANTS MIGHT BETTER BE SCATTERED THAN CONCENTRATED IN COMPACT COLONIES. AVAILABLE LANDS OCCUR IN LIMITED TRACTS.

BRITISH HONDURAS. (BELICE) INTERIOR HILL COUNTRY OF THE SOUTH WOULD SEEM TO OFFER PLACE FOR MANY SETTLERS IN COUNTRY BETTER THAN IN BELICE WHERE OVER 1,000 WHITES ALREADY LIVE. THIS WOULD STRENGTHEN BRITAIN'S HOLD ON THE TERRITORY

- 5 -

CALA 5/172

PANAMA. THE PACIFIC SLOPE WESTWARD FROM THE CANAL TO THE COSTARICA BORDER WOULD SEEM TO OFFER ROOM AND SUITABLE CONDITIONS FOR SEVERAL 10,000 GROUPS. ISOLATED VALLEYS WITHIN THE CHIRIQUI MOUNTAINS ALSO OFFER LIMITED SITES AT ELEVATIONS OF 1,000 TO 2,000 FEET. THE COASTAL PLAINS ARE SPARSELY INHABITED AND THE FOOTHILLS LARGELY UNDEVELOPED. THE REGION IS DRY ENOUGH FOR HEALTHFUL LIVING, BUT WITH SUFFICIENT RAIN FOR PASTURE, CEREAL CULTIVATION AND FRUIT GROWING. ACCESS TO PORTS IS EASY AND A ROAD FROM THE CANAL REACHES TO BEYOND DAVID.

SALVADOR. THIS COUNTRY PROBABLY OFFERS NO POSSIBILITIES DUE TO DENSE POPULATION AND INTENSIVE DEVELOPMENT. GENERAL CONSIDERATIONS.

HUMID LOWLANDS HAVE NOT BEEN SUGGESTED BECAUSE OF UNSUITABLE HEALTH CONDITIONS. EACH OF THE SEVERAL COUNTRIES COULD PROBABLY ABSORB A LIMITED NUMBER OF INDIVIDUALS PARTICULARLY OF THE PROFESSIONAL CLASSES AND THOSE FINANCIALLY ABLE AND PREPARED TO UNDERTAKE INDUSTRIAL OR HORTICULTURAL ENTERPRISES. WE WOULD STRESS SUBTROPICAL HORTICULTURE FOR COLONY ACTIVITY, AS YET UNTRIED ON LARGE SCALE BUT EVERYWHERE SUCCESSFUL ON A SMALL SCALE.

GEORGE M MCBRIDE 710 VIA DE LA PAZ  
PACIFIC PALISADES CALIF.

COPY

## WESTERN UNION

CAL4 811 NL COLLECT 7 EXTRA 1/141 - SANTAMONICA CALIF 19

DR ISAIAH BOWMAN  
OAK PL BALTO

THE FOLLOWING STATEMENT PREPARED AFTER CONSULTATION WITH MY COLLEAGUES DOCTORS FITZGIBON POLITICAL SCIENCE AND HUSSEY HISTORY BOTH OF WHOM SPENT RECENT MONTHS IN CENTRAL AMERICA. THIS SUMMARIZES OPPORTUNITIES FOR AGRICULTURAL COLONIES. INDUSTRIAL AND COMMERCIAL OPENINGS FOR LIMITED NUMBER MIGHT BE EXPECTED IN TIME. WAGES FOR AGRICULTURAL AND INDUSTRIAL LABOR EXTREMELY LOW IN ALL SECTIONS. ROAD SYSTEMS BEING ACTIVELY EXTENDED IN MOST COUNTRIES AND AIR SERVICE MAKES MANY REGIONS NEWLY ACCESSABLE.

COSTARICA OFFERS BEST POSSIBILITIES FOR SEVERAL 10,000 GROUPS. COUNTRY DEMOCRATIC AND SYMPATHETIC TOWARD IMMIGRATION. UPPER RIM OF MESETA CENTRAL AND UPPER SLOPES BEYOND THAT RIM CONTAIN FERTILE VOLCANIC SOIL WELL DRAINED EASILY CLEARED AT ELEVATION OF 3,000 TO 6,000 FEET. WHILE LOWER ELEVATIONS OF MESETA ARE THICKLY PEOPLED HIGHER ELEVATIONS ARE SPARSELY INHABITED. DISTANCE TO MARKET NOT GREAT OVER FAIR ROADS RAPIDLY BEING IMPROVED. CLIMATE EXCELLENT. WESTWARD SLOPE TOWARD NICARAGUA ALSO SPARSELY

- 2 -

CA14 2/160

INHABITED AND ABOVE 3,000 FEET OFFERS POSSIBILITIES PARTICULARLY ABOUT HEADWATERS OF SANCARLOS AND ON PACIFICWARD SLOPE. PENINSULA OF NICOYA ALSO OFFERS POSSIBILITIES AS DOES RATHER ROUGH MOUNTAIN TERRAIN OF TALAMANCA CORDILLERA. MOST OF REGIONS MENTIONED ARE SUITABLE FOR CEREALS BEANS AND FRUITS FOR SUBSISTANCE AGRICULTURE AND COFFEE FOR EXPORT. THIS COUNTRY PARTICULARLY ATTRACTIVE BECAUSE POPULATION IS MOSTLY WHITE.

HONDURAS. MOST OF HIGHLAND 3,000 TO 5,000 FEET ELEVATION CONTAINS SPARSE POPULATION. THE SOIL IS GOOD THE RAIN VARIES FROM 30 - 50 INCHES RESULTING IN A GOOD GROWTH OF VEGETATION AND EXCELLENT FORESTS OVER MUCH OF THE AREA. LONG DRY SEASON FROM NOVEMBER TO APRIL OFFERS A PROBLEM AND HAS HELPED TO KEEP AGRICULTURAL DEVELOPMENT DOWN BUT SHOULD NOT PREVENT EXTENSIVE PROFITABLE GRAIN FARMING IF ROADS ARE CONSTRUCTED AS OUTLETS TO MARKET THOUGH INTENSIVE AGRICULTURE MAY NEVER BE POSSIBLE. A MUCH LARGER ANIMAL POPULATION SHOULD BE POSSIBLE ALSO WITH INTELLIGENT MEASURES AGAINST TICKS WHICH NOW CONSTITUTE A SERIOUS HANDICAP.

- 3 -

CAL4 3/160

MINING TOO OFFERS GOOD POSSIBILITIES KNOWN DEPOSITS OF GOLD AND SILVER BEING NUMEROUS. THESE AREAS ARE SUITABLE FOR PIONEER SETTLEMENTS AND WITH FURTHER EXTENSION OF ROADS AND RAILROADS SHOULD SUPPORT MANY 10,000 GROUPS. PINE LUMBERING INDUSTRY ALSO PROMISING. ATTITUDE OF GOVERNMENT TOWARD IMMIGRATION DOUBTFUL.

NICARAGUA. UPLANDS FROM MATAGALPA TO UPPER SEGOVIA REGION SPARSELY INHABITED BUT CAPABLE OF SUSTAINING TWO OR THREE 10,000 GROUPS BY SUBSISTANCE AGRICULTURE, TROPICAL AND SUBTROPICAL HORTICULTURE, AND COFFEE PRODUCING FOR EXPORT IF MARKET EXISTS. ROADS FROM MANAGUA AND TO ATLANTIC COAST RIVERS BEING IMPROVED.

GUATEMALA. TWO REGIONS OFFER GOOD PROSPECTS. HIGHLANDS OF ALTA VERA PAZ 3,000 to 4,000 FEET ELEVATION HAVE HEALTHFUL CLIMATE, RICH SOIL, ABUNDANT VEGETATION; HEAVY RAINS, BUT WITH GOOD DRAINAGE DUE TO UNDERLYING LIMESTONE. ROAD SYSTEM UNDER CONSTRUCTION; RAILWAY AND RIVER OUTLET TO LIVINGSTON; AIR LINE TO GUATEMALA CITY. ANOTHER REGION IS HIGHER PART OF WESTERN END PACIFIC COASTAL PLAIN EAST AND WEST FROM COATEPEQUE AND ALONG FOOT OF VOLCANIC RANGE



- 4 -

CAL 4/178

EASTWARD FROM THERE. THIS IS PIEDMONT SLOPE ABOUT 1,000 FEET HIGHER THAN NEIGHBORING UNITED FRUIT COMPANY BANANA REGION, WELL DRAINED VOLCANIC SOIL SUFFICIENT RAINFALL AND EXCELLENT WATER SUPPLY. SOME DANGER OF MALARIA. GOOD FOR CATTLE, SUGAR CANE, CORN, BEANS, TROPICAL AND SUBTROPICAL FRUITS. ROADS LEAD TO GUATEMALAN HIGHLANDS AND RAILROADS TO PORTS OF OCOS AND CHAMPERICO. PRESUMABLY THE PETEN REGION THOUGH ONCE OCCUPIED BY POPULOUS MAYAN CITIES IS IMPOSSIBLE NOW UNLESS AN EXTENSIVE PROGRAM OF MALARIA ERADICATION COULD BE CARRIED OUT. THE TWO RECOMMENDED GUATEMALAN REGIONS ALREADY CONTAIN MANY GERMAN FINCAS, MAINLY COFFEE FARMS, ALSO SOME INFLUENTIAL ENGLISH AND AMERICAN FARM OWNERS. SUBTROPICAL HORTICULTURE AS YET UNEXPLOITED BUT PROMISING. GOVERNMENT LIKELY TO FAVOR IMMIGRANTS, BUT SOME FOREIGN LAND OWNERS LIKELY TO OPPOSE. IN BOTH REGIONS IMMIGRANTS MIGHT BETTER BE SCATTERED THAN CONCENTRATED IN COMPACT COLONIES. AVAILABLE LANDS OCCUR IN LIMITED TRACTS.

BRITISH HONDURAS. (BELICE) INTERIOR HILL COUNTRY OF THE SOUTH WOULD SEEM TO OFFER PLACE FOR MANY SETTLERS IN COUNTRY BETTER THAN IN BELICE WHERE OVER 1,000 WHITES ALREADY LIVE. THIS WOULD STRENGTHEN BRITAIN'S HOLD ON THE TERRITORY

- 5 -

CA14 5/172

PANAMA. THE PACIFIC SLOPE WESTWARD FROM THE CANAL TO THE COSTARICA BORDER WOULD SEEM TO OFFER ROOM AND SUITABLE CONDITIONS FOR SEVERAL 10,000 GROUPS. ISOLATED VALLEYS WITHIN THE CHIRIQUI MOUNTAINS ALSO OFFER LIMITED SITES AT ELEVATIONS OF 1,000 TO 2,000 FEET. THE COASTAL PLAINS ARE SPARSELY INHABITED AND THE FOOTHILLS LARGELY UNDEVELOPED. THE REGION IS DRY ENOUGH FOR HEALTHFUL LIVING, BUT WITH SUFFICIENT RAIN FOR PASTURE, CEREAL CULTIVATION AND FRUIT GROWING. ACCESS TO PORTS IS EASY AND A ROAD FROM THE CANAL REACHES TO BEYOND DAVID.

SALVADOR. THIS COUNTRY PROBABLY OFFERS NO POSSIBILITIES DUE TO DENSE POPULATION AND INTENSIVE DEVELOPMENT. GENERAL CONSIDERATIONS.

HUMID LOWLANDS HAVE NOT BEEN SUGGESTED BECAUSE OF UNSUITABLE HEALTH CONDITIONS. EACH OF THE SEVERAL COUNTRIES COULD PROBABLY ABSORB A LIMITED NUMBER OF INDIVIDUALS PARTICULARLY OF THE PROFESSIONAL CLASSES AND THOSE FINANCIALLY ABLE AND PREPARED TO UNDERTAKE INDUSTRIAL OR HORTICULTURAL ENTERPRISES. WE WOULD STRESS SUBTROPICAL HORTICULTURE FOR COLONY ACTIVITY, AS YET UNTRIED ON LARGE SCALE BUT EVERYWHERE SUCCESSFUL ON A SMALL SCALE.

GEORGE M MCBRIDE 710 VIA DE LA PAZ  
PACIFIC PALISADES CALIF.



TREASURY DEPARTMENT

86

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE November 21, 1938

TO Secretary Morgenthau  
FROM Mr. Hase   
Subject: The Business Situation,  
Week ending November 19, 1938. 

Conclusions

(1)

A marked improvement in new buying during October and early November, which has built up backlogs of unfilled orders in the steel and automobile industries, will be an important sustaining factor in production during the remainder of the year. An FRE index of about 100 is expected for November, as compared with 95 in October.

(2)

The sensational upturn in automobile output, which dominates the current business rise, is backed up by consumer buying in excess of current production and by low levels of new- and used-car inventories. Production has apparently not yet reached the level of basic demand, according to tentative estimates for November, although it is approaching that level.

(3)

Somewhat greater caution in appraising the early 1939 outlook is suggested by (a) an apparent further weakening in the economic situation abroad, reflected in declines in foreign currencies and heaviness in foreign security markets; (b) declines in domestic stock prices to below the pre-election lows; and (c) a closer approach of industrial production to the estimated demand level, making it temporarily more vulnerable to adverse influences.

Secretary Morgenthau - 2

### Automobile expansion speeds recovery

Looking at the business situation as of mid-November, we find it dominated by a sensational recovery in the automobile industry. Automobile output has expanded in successive weekly gains since the middle of September, this week's output of 96,700 units establishing the highest production rate since August 1937. (See Chart 1.) The automobile industry has been largely responsible for the rapid fall improvement in steel output, and for increased production in several related industries.

The foundation for the abrupt recovery was laid last spring and summer, when the efforts of automobile companies to work off heavy new-car inventories resulted in production being depressed far below the level of demand. By this curtailment of production the companies were successful in reducing not only new-car stocks, but stocks of used cars as well, to normal or sub-normal levels in relation to sales, thus creating a situation where new-car demand would be reflected immediately in production.

The combination of decided changes in 1939 models, reduced prices, and increased business optimism, has resulted in an excellent sales response this fall. General Motors' average daily sales to domestic consumers during the first 10-day period of November, 4,500 units, equalled that for the same period last year. A more satisfactory production outlook than last year is indicated by the fact that General Motors' output of 80,900 units during the first two weeks of November compares with 91,500 units produced during the corresponding period a year ago, while its stocks of new cars at the end of October, 72,800 units, compares with stocks of 151,600 units at the same date a year ago. The immediate outlook for the industry, as indicated by data of this corporation, appears a healthy one.

Trade reports mention that backlogs of orders for practically all automobile companies are at the best levels in at least 12 months, and that retail deliveries in several instances are being delayed as much as five weeks. This is expected to hold production at relatively high levels during the remainder of the year.

Secretary Morgenthau - 3

In the longer term outlook, the trend of consumer demand will be the determining factor in production. A total domestic production of about 385,000 units now seems likely during November, which would raise the FRB adjusted index of automobile production to about 100. We have made a tentative estimate of basic demand for November (Shown on Chart 2), which rises above the level of production, due to an expected further increase in factory payrolls and an expected rise (on a seasonally adjusted basis) in farm incomes. It will be noted in Chart 2 that on a few occasions in the past several years automobile production has increased beyond the level of basic demand, but that in each case a setback has shortly followed.

#### Steel output at higher rate

Steel ingot output increased this week to a new high for the year at 62.6 per cent of capacity, representing a gain of 1.6 points over the previous week. New orders reported this week by the U. S. Steel Corporation were at the equivalent of 62 per cent of capacity, approximately the same as the current operating rate for the industry. This represents a decline from last week's orders, which were at an equivalent rate of 71 per cent. With the support of large backlogs of unfilled orders booked at recent low prices, nearly all mills, according to the Iron Age, will be able to maintain their present operating rates to the end of the year.

The rise in steel operations has been accompanied by a general advance in steel scrap prices, which has raised the Iron Age composite price to a new high for the year at \$14.88 a ton. This compares with a price of \$14.50 last week.

Some observers in the steel trade, as well as economic analysts, express the opinion that steel production currently is in excess of actual consumption, since mills have speeded up production in order to complete delivery by the end of December on recent orders for automobile steel taken at low prices. With these orders the automobile companies have filled at least a part of their requirements for the first quarter of 1939.

Tentative estimates of basic demand for steel (See Chart 3) indicate that steel production during November has increased to approximately the level of demand. On several occasions in the past few years production has exceeded the demand level, as estimated by this method, but in most of these cases a temporary decline has almost immediately followed the excessive production. An exception was in the fall of 1936 and the first half of 1937, when an extended period of over-production was followed by a prolonged recession in steel output.

Secretary Morgenthau - 4

Some possibility of a flattening out of steel operations around present levels is suggested by declines scheduled for next week in several districts. The Chicago district will start the week at 57.4 per cent, down 3 points, and Youngstown at 61 per cent, off 2 points. The rate at Pittsburgh, less affected by automobile demand, is estimated for next week at 48 per cent, down 3 points.

New orders in October sharply higher

Industrial activity during November is being supported by an increase in new orders during October, which has raised our monthly index (preliminary estimate) to the highest level since August 1937. (See Chart 4.) Substantial increases are reported in orders for steel, automobiles, textiles, and building materials.

Weekly data indicate that the rising trend of orders continued through the first week of November, but some setback was recorded during the following week, probably because of the election and Armistice Day holidays.

Some uncertainty in outlook for early 1939

Indications suggesting some degree of caution in appraising the outlook for early 1939 have assumed more prominence this week. They include (1) an apparent further weakening in the foreign situation, as reflected in declines in sterling and franc exchange to below the closing quotations on the day of the Munich lows, and heaviness in foreign security prices; (2) a decline in domestic stock prices to levels below the pre-election lows; and (3) indications that industrial production has risen to about the level of demand, and has therefore become temporarily more vulnerable to adverse influences.

Weakness in the foreign situation, affecting our domestic economy at a number of points, appears the most important handicap in the road to continued domestic recovery. A substantial decline in sterling and the franc this week, together with weakness in the leading stock markets abroad, which has carried British rail stocks below the "war scare" levels established in September, seems to indicate a deterioration in the foreign situation as it affects American business.

To bring about a continued expansion of business activity after production of the major consumer goods has reached the current levels of demand, one of two things seems necessary: (1) an expansion of production in the capital goods industries, or of such consumer goods as have not yet reached the demand

Secretary Morgenthau - 5

level, or (2) an increase in consumer demand. Both of these will be affected by sentiment regarding the business outlook. For this reason any developments in the foreign situation, in prices, or in the stock market, which tend to affect sentiment regarding the outlook for business, may be particularly influential as business factors at the present levels of production.

From the foregoing point of view, the appearance of weakness in domestic stock prices this week seems of some significance. Price averages for all three major stock groups have declined to slightly below the lowest levels of the past month. In view of the increase in business optimism generated by the post-election rise, the decline in stock prices to below the pre-election lows may have some unfavorable reaction on business sentiment.

Summing up the business outlook, it appears that current backlogs of unfilled orders, together with an expected continued good demand for automobiles, should tend strongly toward sustaining production during the remainder of the year. In past experience, however, an uninterrupted business rise lasting as long as six months has nearly always been followed by a period of hesitation or setback. Current business data provide some indications of increasing uncertainty in the outlook. For these reasons a temporary flattening out of the business trend during the early part of 1939 would not be surprising, and would be in line with normal tendencies in a general recovery trend. No real maladjustments in the business structure that might suggest a more pronounced recession have yet appeared.

#### Current business news

The New York Times index of business activity for the week ended November 12 rose .7 point to a new high for the year at 90.3, exceeding for the first time the corresponding 1937 level. While the increase in automobile production during the week was somewhat less than seasonal, thus lowering the adjusted index, the steel production index showed a substantial advance. Lumber production was sharply lower, possibly reflecting a greater influence of holidays than allowed for in the seasonal adjustment. The electric power index gained 1 point, the index for "all other" carloadings was 2.3 points lower, and other components showed minor changes. For the following week, the automobile index will be sharply higher and the steel index moderately higher, these being the only two components so far available.

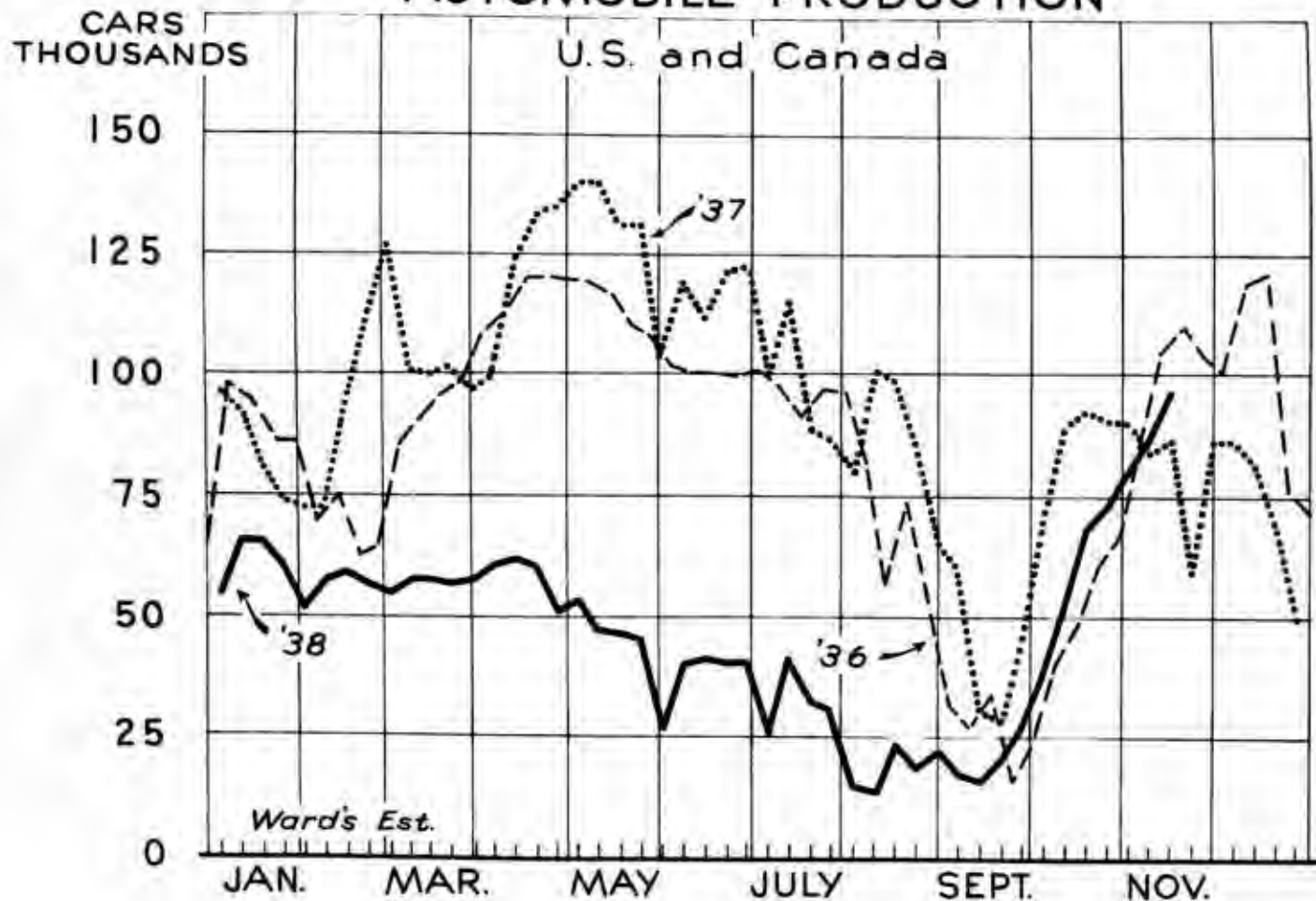
Secretary Morgenthau - 6

Federal Reserve Board statisticians unofficially look for an FRB index of around 100 for November, on the basis of industrial trends to date. This compares with a preliminary index of 95 for October.

Department store sales last week made the most favorable comparison with last year of any week in recent months. Total sales of reporting stores were 1.3 below the sales in the corresponding week of last year.



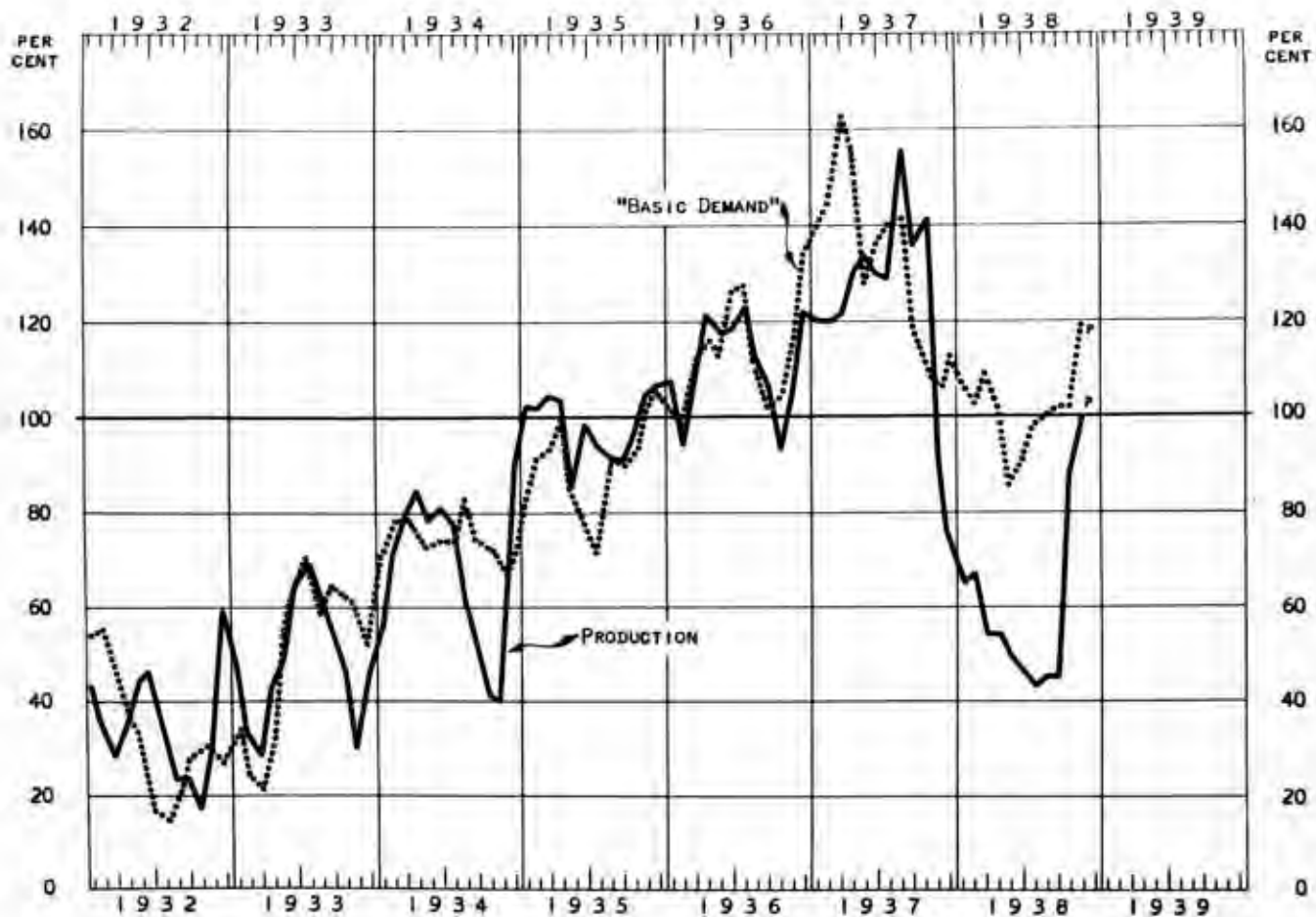
# AUTOMOBILE PRODUCTION



MOBILESS

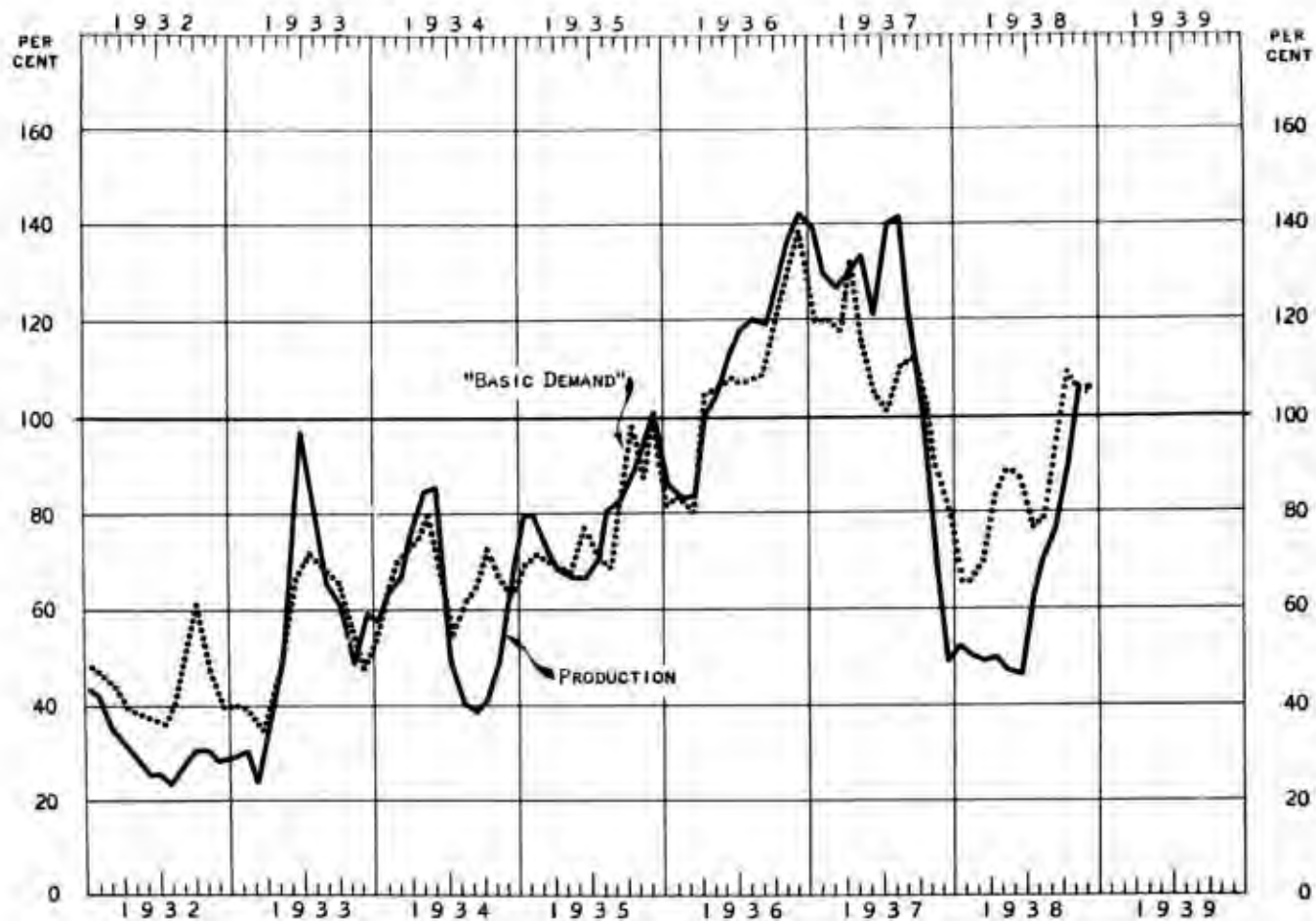
Production Compared With Estimated "Basic Demand"

1923 = '25 = 100

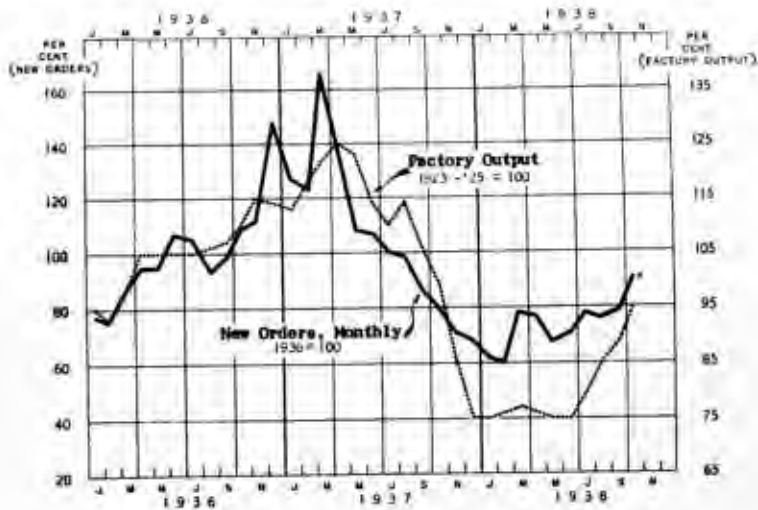


IRON AND STEEL  
Production Compared With Estimated "Basic Demand"

1923 = 100

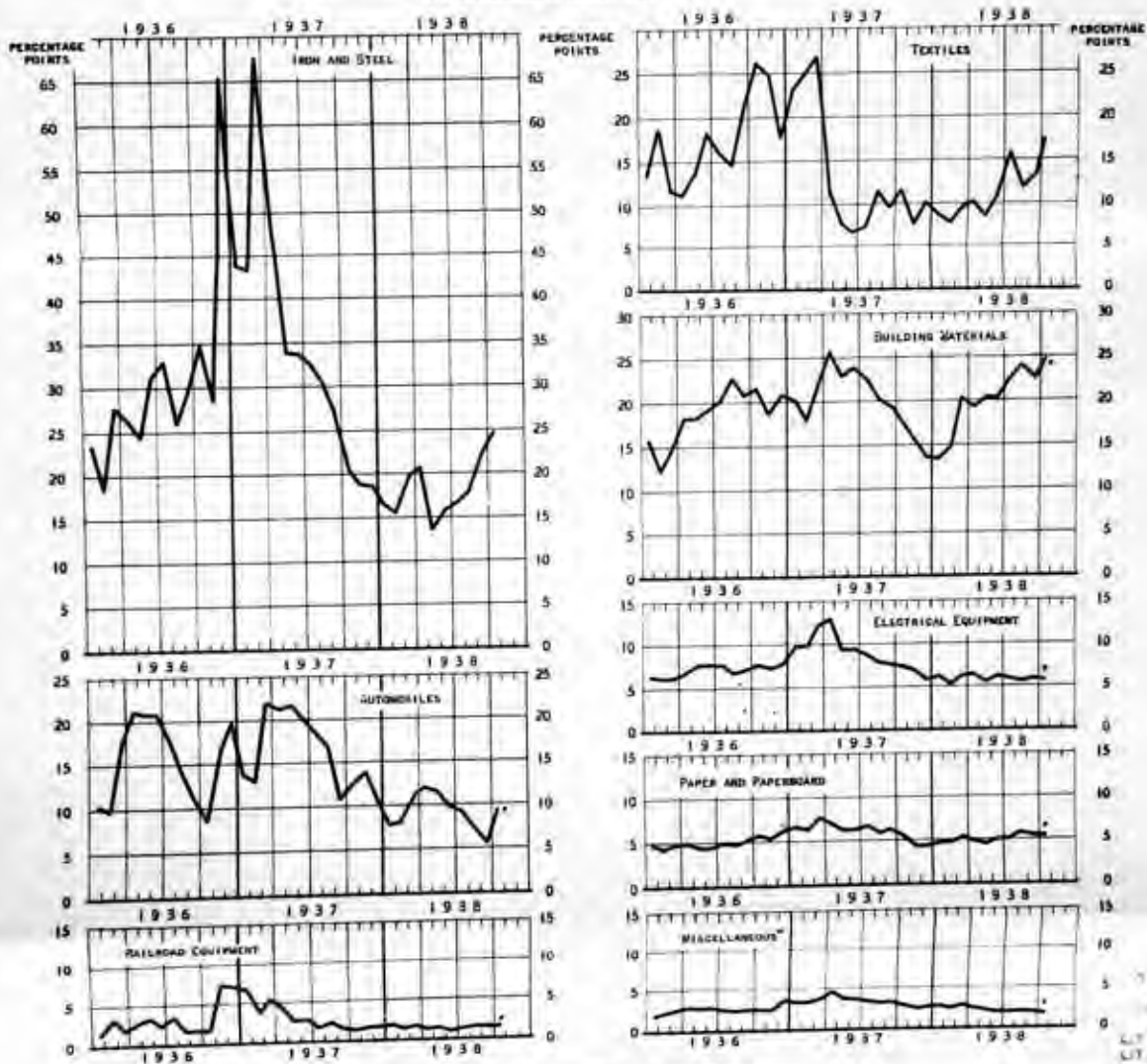


# NEW ORDERS AND FACTORY OUTPUT



## New Orders Grouped by Industries

WEIGHTED ACCORDING TO RELATIVE IMPORTANCE



\* INCLUDES MACHINE TOOLS, AGRICULTURAL EQUIPMENT AND OTHERS

Chart 4  
 CONTINUED  
 1938

STANDARD FORM NO. 14A  
APPROVED BY THE PRESIDENT  
MARCH 10, 1925

# TELEGRAM

OFFICIAL BUSINESS—GOVERNMENT RATES

COLONEL MARVIN H. McINTYRE,  
WARM SPRINGS, GEORGIA.

PLEASE DISREGARD MY TELEGRAM OF TODAY IN RE LIEUTENANT McKAY

HENRY MORGENTHAU JR.

TREASURY DEPARTMENT

WASHINGTON

CHARGE TREASURY DEPARTMENT, APPROPRIATION FOR

**Official**

(The appropriation from which payable must be stated on above line)

U. S. GOVERNMENT PRINTING OFFICE 2-18117

November 21, 1938.

STANDARD FORM No. 14A  
APPROVED BY THE PRESIDENT  
MARCH 10, 1926

# TELEGRAM

OFFICIAL BUSINESS—GOVERNMENT RATES

COLONEL MARVIN H. McINTYRE,  
WARM SPRINGS, GEORGIA

TREASURY DEPARTMENT  
WASHINGTON

CHARGE TREASURY DEPARTMENT, APPROPRIATION FOR  
**Official**

(The appropriation from which payable must be stated on above line)

U. S. GOVERNMENT PRINTING OFFICE 2-11117

November 21, 1938.

LIEUTENANT McKAY COAST GUARD ARRIVES ATLANTA AIRPORT ELEVEN FIFTY FIVE  
MONDAY NIGHT NOVEMBER TWENTY FIRST STOP I HAVE ARRANGED TO HAVE CAR  
DRIVE HIM TO WARM SPRINGS AND WOULD APPRECIATE YOUR HAVING A ROOM  
RESERVED FOR HIM STOP McKAY IS CARRYING A VERY CONFIDENTIAL AND  
MOST IMPORTANT DOCUMENT WHICH I WOULD LIKE VERY MUCH FOR THE PRESIDENT  
TO HAVE THE FIRST THING TUESDAY MORNING NOVEMBER TWENTY SECOND STOP  
WOULD APPRECIATE YOUR COOPERATION

✓  
Henry Morgenthau, Jr.

TREASURY DEPARTMENT  
Office of the Secretary  
Secret Service Division

98

MEMORANDUM

November 21, 1938

To: Mrs. Klotz  
From: Chief Wilson

AS requested by the Secretary we have arranged to have an agent meet Lieutenant McKay at the Atlanta Airport 11:55 tonight and convey him to Warm Springs and bring him back to Atlanta when his mission is performed.

file 11-19-38

November 21, 1938.

Dear Mr. Sproul:

For the Secretary I am acknowledging your letter of November 19th, giving a report on the corporate new security financing for the past week. As usual, Mr. Morgenthau was very much interested in the comments contained in your letter.

Sincerely yours,

H. S. Klats,  
Private Secretary.

Mr. Allan Sproul,  
First Vice President,  
Federal Reserve Bank of New York,  
New York, New York.

RECEIVED  
NOV 23 1938  
FEDERAL RESERVE BANK OF NEW YORK  
COMMUNICATIONS SECTION

GXF/ab



FEDERAL RESERVE BANK  
OF NEW YORK

November 19, 1938.

Dear Mr. Secretary:

Corporate new security financing completed this week was confined to one issue - \$9,000,000 serial notes sold by Pan-American Petroleum Company, to a bank and an insurance company, to fund temporary loans used mainly to pay for new oil tankers. Plans for an increased amount of business borrowing are progressing, however. The Philadelphia Electric Company is to obtain \$30,000,000 of new capital through the sale of first mortgage 3 1/4 per cent obligations to insurance companies; about \$75,000,000 of utility company new issues have been filed with the Securities and Exchange Commission under the Holding Company or the Securities Act, principally for refunding, and another \$55,000,000 utility refunding operation is expected to be registered in a few days. The prospective issues, reported last week, will become eligible to emerge from registration next week or the week following. Numerous other transactions are reported to be in preparation.

Liquidation by investment trusts of utility company stocks, in order to bring their holdings under 10 per cent of any one company's voting stock, thus avoiding classification as a holding company under the Public Utility Holding Company Act, will begin shortly to add to the volume of securities offered. Common stock of the North American Company worth about \$17,500,000 at the current market has been registered for sale for the account of two investment trusts, and United Corporation has announced its more distant intention of disposing of several large blocks of stock. In recent years practically no flotations of common stock of utility companies have been attempted, because of

their low prices and public misgivings concerning their future safety. United Corporation has also announced that it intends to enter the business of underwriting security issues of all kinds of industries, devoting upwards of \$30,000,000 to this purpose. This would, of course, be a very important addition to the market's underwriting capacity.

The largest issue floated this past week was \$40,000,000 Dominion of Canada 3s of 1968 at 97 1/4, to yield 3.14 per cent, to refund notes maturing January 1. The issue was quickly sold and quoted at a fractional premium. The \$25,000,000 Argentine issue marketed November 3rd, having come out of syndicate, is quoted about 2 points below the offering price of 95 1/2. No other foreign government security borrowings in this market are now in prospect.

Municipal awards this week amounted to over \$31,300,000, of which the largest was \$19,400,000 Massachusetts 0.75 per cent hurricane and flood damage bonds, due 1939-43. A large award by Connecticut is scheduled for Monday, and one by New York City sometime in the next few days.

Yours faithfully,



Alan Sproul,  
First Vice President.

Hon. Henry Morgenthau, Jr.,  
Secretary of the Treasury,  
Treasury Department,  
Washington, D.C.

MEETING OF FISCAL AND MONETARY  
ADVISORY COMMITTEENovember 21, 1938.  
10:15 a.m.

Present: Mr. Eccles  
Mr. Bell  
Mr. Ruml  
Mr. Hanes  
Mr. Taylor  
Mr. Haas  
Mr. White  
Mr. Currie  
Mr. McReynolds

H.M.Jr: Well, supposing we start. We'll teach some of these boys around Washington what it is to be punctual. Have you got a ....

Ruml: I made up a little agenda. (Hands to H.M.Jr)

H.M.Jr: I wished something on you; I don't know whether you're going to take it on. Fortune Magazine - did you hear about it?

Ruml: Uh-huh.

H.M.Jr: They're doing six round tables on Government. The first one is Government spending. And they've got had a couple fellows... Leon Henderson said it wasn't so hot. I can't think of this one fellow - always used to write for Harper's - what's his name?

Taylor: Coyle.

H.M.Jr: Incidentally, whose payroll is Coyle on anyway?

Taylor: Ickes', I think.

H.M.Jr: They wanted somebody from Treasury. I said no; so I suggested you.

Ruml: Well, I talked to the gentleman and I said my presence there - "I would be very glad to go, but don't be surprised if I don't tell you all I know." He said, "All right, just come and be critical." So I said I would.

H.M.Jr: I thought it would be good.

-2-

Ruml: Very timely. It comes in March.

H.M.Jr: I thought it would be all right.

(Eccles comes in)

Good morning.

Eccles: Good morning.

H.M.Jr: You haven't missed a thing, Marriner. Didn't even declare a dividend.

Eccles: Sorry for that.

Ruml: Mr. Secretary, the first thing I'd like to find out is when the next meeting will be, because I didn't find out about this one until last Friday.

H.M.Jr: That's what Mr. McReynolds is supposed to do. I don't know what I told him.

(Bell comes in)

Well, I want, unless there is some material - I'd like a little bit to skip next week, because that's my financing week, and I'd like to go to two weeks from today; or rather, here's the thing: we come out with our financing on the 5th, which is a bad day, so how about Tuesday the 6th? Is that too far off? I can do it during the week.

Ruml: Monday the 5th - I cannot make it on Tuesday. Mr. Secretary, I think that by next week we may have the 1937 and 1938 budgets analyzed from this point of view. If we can make it Monday the 5th, perhaps, or ....

H.M.Jr: Well, I can, but - if you don't mind my jumping up and down a couple times.

Ruml: Well, Monday the - when we take this presentation of the two budgets, it's going to be, I think, quite dramatic.

H.M.Jr: Must it be in the morning?

-3-

Ruml: No, I'd rather have it in the afternoon.

H.M.Jr: Have a press conference Monday. I guess we'll have to make it Monday the 5th. It's all right with me. As I say, let's start by 10:30; by that time we'll know whether the bonds are successful or not. 10:30 Monday the 5th - telephone and telegraph.

McR: Yes, sir.

H.M.Jr: Is that all right with you, Marriner?

Eccles: Yes, that suits me fine. Isn't it ....

H.M.Jr: Yes, by 10:30 we'll know whether the issue is a success.

Eccles: You're not worrying, are you?

H.M.Jr: I always worry until it's over. I'm like the actor; they say if he doesn't worry on the opening night, he gives a bum performance.

Eccles: I see.

H.M.Jr: Well, lacking somebody else's having an agenda, I'll accept Mr. Ruml's. And he's got down here - and I want you to know that I'm never prepared - I mean he just writes it during his sleep, so you men - anybody that wants anything down on the agenda see Mr. Ruml. I take it as he gives it to me, so the meeting as far as I'm concerned is not - there is no trading going on before.

"1. National income and budget - Treasury."

Ruml: That's - I might say, Mr. Secretary, that all I've done is to list the seven topics that we have had consistently before us, so the meeting has not been jammed. This is Mr. Haas's report.

H.M.Jr: "National income and budget - Treasury." *See meeting 11/14/58 10:50*

Haas: You might recall the last time, Mr. Secretary, that I said that we had it worked up on one basis, and you asked if anybody was interested in seeing that basis, they should come in and see me. I talked with Currie about it, but he wasn't interested in that

-4-

phase. But we have that worked up on one basis, and I'm working it up on this more complex basis which will take till some time in January. That's - the status of that is the same - somewhat skeptical whether we can even complete it in January - the complex one.

H.M.Jr: This is so brief, I don't understand it. What is it, George?

Haas: It is the determination of what on the basis of the present tax structure - what would be the tax yield at various levels of national income, by various price levels.

H.M.Jr: Oh, by price levels.

Haas: National income can be arrived at - you can get the same national income by having different price levels.

H.M.Jr: But you gave us one.

Haas: Yes, but that just assumes one condition with regard to price levels. You get all kinds of combinations. That's what takes the tremendous computation. I think, though, that if Mr. Ruml - some of us get together, that what I have done may fit the immediate purpose. Don't have to go through all that.

H.M.Jr: Well then, we've got to see some ....

Haas: Well, I've got what I've already done here. You've seen that.

H.M.Jr: But nothing since then.

Haas: No.

H.M.Jr: Because, going over to the President - Hanes, Bell and I - we're using those figures, I mean; the President is much more national-income-minded now, which I take it pleases all of you. And he'll want to know about various levels of national income, how much revenue could be expected on the present tax base; and Hanes was giving him those figures. Is that right, John?

Hanes: That's right.

-5-

H.M.Jr: Now, if those "ain't" right ....

Haas: Oh, they're all right.

H.M.Jr: What?

Haas: They're all right. You can get national income - they're all right, on these assumptions, Mr. Secretary. For example, one assumption we have made, which is clearly indicated, is that we assumed arbitrarily the price level would rise from 80 somewhat to 100 in ten years. We just assumed that.

H.M.Jr: Well now, look, I'm not going out on the end of a limb for anybody, and I'm not going to put the President out on the end of a limb. We're telling him that at \$60,000,000,000 on the present basis he can get around \$5,000,000,000.

Hanes: Four billion, 992.

H.M.Jr: Well, five. And then the President says, at 70 billion, which is a hope, as he puts it, we could get ....

Hanes: Six billion seven.

H.M.Jr: How much?

Hanes: Six, seven.

H.M.Jr: Six, seven.

Bell: But based on other indices, too - price level and Federal Reserve Board.

H.M.Jr: Yes. Is that all right? ...

Haas: With the combination of indices as indicated on the chart, that's all right, but it doesn't mean this, Mr. Secretary, that when we say that the - when this chart shows at the end 100 billion dollars national income with 149 in the Federal Reserve index of industrial production, and also have there 100 (price level) - well, that particular combination of those two indices is purely arbitrary. We say with that combination you get 100 billion dollars national

-6-

income, and with 100 billion dollars national income you get such and such revenue.

- H.M.Jr: Well now, wait a minute, George, if we can tell the President that at 60 billion dollars he'll get - with the present tax base, he gets so much revenue, at 70 he gets so much, why can't you tell him at 80, 90, and 100?
- Haas: That's right, you can.
- H.M.Jr: Well, what are we waiting for? Why do I have to wait until January?
- Haas: Well, Mr. Ruml, some of the other people, were interested in a 100 billion dollar national income and an 80 billion dollar national income which would be arrived at at price levels other than the ones we assumed.
- H.M.Jr: Let me just - because - let me just thrash this out, I mean, here, because it's important, I want to get it. If what we're telling the President - George Haas is willing to sign it and stake his professional reputation on the figures that we're giving him, which the President most likely would use publicly, that at 60 billion dollars the Treasury tells him he'll get roughly five billion dollars and at 70 billion dollars, he'll get roughly ...
- Hanes: Six, seven.
- H.M.Jr: ... six, seven - now, what the hell more does anybody want?
- Haas: Well, this point ....
- H.M.Jr: What I'm trying to get at is, are we over-complicating this thing - I mean making it so complicated that everything is stalled?
- Ruml: No.
- H.M.Jr: See?
- Ruml: It is very important, on the intermediate - I don't care about 100 billion dollars, we'll take that when



-7-

we get it - but it's very important on the intermediate that we find out how much disorganization is produced by a changed assumption on price level. You may have to get your income without an increase in price level; have to find out what that is.

H.M.Jr: What I'm getting at, Ruml, is that I want them to do everything that they can here to help all of us, but on the other hand - I mean why are the figures satisfactory for 60 and 70 and not satisfactory for 80, 90, and 100?

Ruml: Because the assumptions with respect to price level may not be realistic.

H.M.Jr: Are they all right at 60 and 70?

Ruml: I should think so.

Haas: Yes.

Ruml: I should think they're probably all right at 80, but I think it's very important at a ...

H.M.Jr: But when this curve begins to go up and reaches 100, that's when you're worried.

Ruml: The thing I'm worried about is, you may not get an increase in the price level as much as 20 percent, or as much as 25 percent; if you don't get an increase of 25 percent, you're going to have an entirely different figure at 100 billion than you have at the present figure.

H.M.Jr: But you're not worried about the estimates at 60 or 70.

Ruml: No, nor even at 80. There may be variations, but I'm not worried about them.

H.M.Jr: But when we get in these other things, that's when you're worried.

Ruml: Not worried, but I'm simply concerned about the accuracy in realistic terms of the figures.

Haas: I think we realize that, and we've got that stated in the memorandum. And I think, Mr. Secretary, you

-8-

should have clearly in mind that the tax yield is not a direct function of a particular level of national income, because you get a different yield depending upon the composition. For instance, you have two national incomes, achieved at different times, of a hundred billion dollars. They may yield different amounts of taxes because the composition may be different. For instance, in one case you may have a larger proportion in wages and salaries; in another instance you may have a larger proportion of dividends. And the tax rates on dividends are different from the tax rates on wages and salaries. So in any case these figures are purely rough approximations, and you have to keep that in mind.

- H.M.Jr: Let me just - well, let me just digress - well, it isn't a digression. Currie, or Mr. Eccles - Mr. Eccles first - have you people made any estimate over there as to what you think the national income will be for the calendar year '39?
- Eccles: Why, we have made an estimate as to what the Federal Reserve index of production would be. I don't know that that's been interpreted into national income. Has it, Currie?
- Currie: (Nods no)
- Eccles: We figure that - the last figures I saw a week ago estimated that the year as a whole would run at 105.
- H.M.Jr: The calendar year.
- Eccles: Yes, the calendar year. Which would mean that there possibly would be a high point during the year of as much as 115 or maybe even 120; that the first part of the year would likely be a good deal lower than the latter part of the year, but, taking the year as a whole, 105. Now, you have to - that naturally would bear a very close relationship to the national income. It hasn't - we haven't undertaken to convert it or to interpret it into national income figures. It could be done, on a rough estimate.
- H.M.Jr: Could you do it for this committee?
- Eccles: Yes, I think we could get at it, don't you, Currie, on certain price level assumptions? 105 should not

-9-

necessarily incur increased - any increases in the average price level. That is, the capacity of the country and the available unskilled labor supply should be such that unless we get up higher than those figures there shouldn't be a material - it should have very little effect upon the price level. It is only when the production index and the national income - and this is what I think Ruml is talking about - get substantially above the prospective levels that we can now see at the moment ....

H.M.Jr: That's why I'm going to ask if you'd be willing, at the meeting of December 5th, to come in with a memorandum on what the best estimate is as to national income for '39. I'll ask Haas to do the same thing separately, you see.

What I'm getting at is, if we're down below 80 billion dollars, and I'm quite sure you will be in your estimates - well then, what we're worrying about is at least something for '40.

Ruml: (Nods yes)

H.M.Jr: What? And then if Haas says, well, he can't bring it in until January, that's all right. But I'd like to have something to be able - an estimate - well, I think you've got two weeks to make an estimate, by December 5th, of what you think the national income will be. The Treasury organization will do one and the Fed will do one, too.

Eccles: What is it?

H.M.Jr: The Fed will do one, too.

Eccles: That's right.

H.M.Jr: Swell. Make a note of that, George.

Haas: Uh-huh.

H.M.Jr: Well now, I think we could move on, don't you, Marriner, from number one? We really have been talking about number two also, haven't we?

Ruml: Number two, there's nothing new to report. The chart I gave last week is all we can do on that,

-10-

all that's necessary.

H.M.Jr: I see.

Ruml: Nothing to do on number two.

H.M.Jr: All right.

Ruml: Number two is in as good form ....

H.M.Jr: Now we come to good old bottlenecks, number three.

Eccles: We had that. This - it was also the question of timing and bottlenecks - was given to us. And in connection with the matter of timing, that isn't on the agenda today, but we have been doing considerable study on it. And Mr. Currie last week brought those charts over, and we worked up some additional charts that should be helpful in approaching this question of timing.

However, it is difficult for us to proceed in this matter until we can get some more information with reference to the 1939-1940 budget figures. We've got here: "The work of a quantitative nature on this problem of timing in '38 and '39 awaits upon the completion of revised budget estimates for the fiscal year '39, and preliminary estimates for the calendar year '40."

Now, both of these - this work is being carried on by the Treasury, and I assume that we ought to be able to get those revised figures, had we not, George, ....

H.M.Jr: No, ...

Eccles: ... because ...

H.M.Jr: ... we haven't got them ourselves.

Eccles: Well, I don't mean immediately, but I mean when you get them.

H.M.Jr: Oh, sure. But I'm telling you - I think it's all right to say what I'm going to say - that we haven't got anything, and this is strictly in this room, as

-11-

a figure from the President on this so-called new program for national defense. So we're completely in the dark. You (Bell) don't mind my saying that.

Bell: No, that's all right.

H.M.Jr: What?

Bell: That's all right.

H.M.Jr: The President left town yesterday leaving Dan and me completely in the dark as to what he wants. So I think ... And we're completely in the dark on the unemployment figures.

Bell: That's right.

H.M.Jr: So until we have those two figures, anything we give you would be just kidding you. We could give you the figures as we had them before we started talking national defense, but it's no use giving you those, and I'm not going to kid you.

Eccles: What that refers to, of course, is the preliminary estimate for the fiscal year '40. There is also the question of the revised estimate for the year '39.

H.M.Jr: Well, that's available.

Eccles: Well, it hasn't been available yet, has it, Currie?

Bell: Not the revised estimates since the budget estimate in July.

Haas: That's the thing we worked up, Mr. Secretary, to put in the January budget.

Bell: 15th of December is the earliest and possibly the 25th, around Christmas, the latest.

Eccles: Well, as soon as we could get ...

H.M.Jr: When would you have it? - excuse me.

Bell: Some time between the 15th of December, the earliest date, and the 25th, 28th, somewhere in there.

McR: Of course, that involves the financial program for the last half of this fiscal year.

-12-

- Bell: Oh yes, that's right.
- McR: You're still almost as much in the dark on that as you are on the other.
- Bell: Except that there is only one item in the 1939 that we will change materially, and that's the WPA program for the last six months.
- Eccles: Yes. Well, of course, there's got to be certain things assumed on all this program. That goes without saying.
- H.M.Jr: Well, you know everything that we know, and we know damn little.
- Eccles: Well, I merely mentioned that in connection with the problem of timing. For us to do any more on it other than just - we've worked out what we feel is a satisfactory method. Now what we need is, as soon as we can get more accurate information, why, then it can be interpreted as to its effect, but without the information, of course, we can do nothing more about it.
- H.M.Jr: Well, I just want you to know that we haven't got anything.
- Eccles: Well, I'd understood that - that it wasn't available yet.
- H.M.Jr: The President doesn't get back until the 5th, and unless Dan insists on going to Warm Springs ....
- Bell: I'm liable to.
- H.M.Jr: ... why, we're not apt to have much more information.
- Bell: I should think they could take the budget summation for 1939, possibly adding 500 million dollars for WPA - or 400 million would be plenty to add.
- H.M.Jr: Huh? Write that and sign your name to it?
- Bell: For '39, yes. Yes, I think on the cash outlay I will. I hope it will be down to 250, but I say 400 as a maximum.

-13-

Eccles: That'll be five months.

Bell: Yes, there's already in the budget 500 million for the five months; then increase that item by 400.

H.M.Jr: Oh.

Bell: And I think you've got plenty in 1939 for the whole program.

H.M.Jr: Oh, you mean 900 million.

Eccles: But increase the present budget.

Bell: Yes, sir. I'm not worried about the other estimates.

Eccles: Well, of course, there's a question too - the R.F.C. put in certain estimates as to what they're going to use, and Public Works, and then it never carries - it doesn't materialize that they - the estimates are made up often from figures that these people submit as to what they're going to use and they don't even come close.

H.M.Jr: You saw our bubble chart.

Eccles: That's what I say.

McR: The trouble with these estimates of Danny is that they do, though.

H.M.Jr: The WPA ....

Eccles: You know the ones you're going to use, but you've got to take these budget estimates and, based on past experience, make your own estimates.

H.M.Jr: We always knock off Jesse Jones 90 percent.

Eccles: At least 90.

Well now, the question of bottlenecks there. Some work has been done on that in connection with what appears to be one of the most obvious developments, and that's the case of the railroads - railroad equipment. Currie, you have those charts, don't you?

(Currie places chart on chair near H.M.Jr)

-14-

Eccles: Yes. Do you want to present the chart first or the memorandum?

Currie: I think perhaps the memorandum and then the chart.

Eccles: Here, you go ahead with it.

Currie: "Under the topic 'Bottlenecks' a study has been initiated of the ability of the railroads to handle the peak loads of prosperous years. As a result of the preliminary survey, certain tentative conclusions emerge, which, if borne out by more intensive study, appear to be highly significant. Although attention has been mostly directed toward freight cars, it is believed that the findings apply to other types of equipment."

The findings are as follows:

"1. It is estimated that to handle the volume of peak traffic consequent upon full recovery within, say, three years, total car requirements would have to approximate 2,000,000 cars."

You notice (on chart) they're down now to one million seven - that's total cars owned, that top line - "... indicating a shortage of 300,000 cars. Adding retirements, the total requirements for" - adding retirements to this, which amounts to about a hundred thousand a year, and making allowance also for putting more of the bad-order cars into service, that gap between those two upper lines - "the total requirements for new cars would amount to about 600,000 units in three years, or approximately 200,000 per year."

H.M.Jr: Excuse me - new cars?

Currie: New cars.

H.M.Jr: New.

Currie: Now, if we take a more modest assumption, "we assume a sufficient degree of recovery by 1940 to represent about the same degree of utilization of our plant capacity in general as prevailed throughout the twenties, which would correspond with a Federal Reserve Board index of production of



-15-

between 125 and 130" - which doesn't seem out of the realms of possibility to achieve in 1940 - "total car requirements would amount to 1,900,000. Taking retirements at about 100,000 per year, this would call for total new car construction of 400,000 in two years" - in the next two years.

"3. To the extent to which new cars produced in 1939 fall short of 200,000, requirements in 1940, to handle the assumed volume of peak traffic, would have to be correspondingly higher than 200,000.

"4. The maximum number of new cars produced in any one year was 150,000 in 1923. This suggests that the capacity in the car making field may be inadequate to handle the volume of possible new requirements. Further study is necessary to verify this indication." The maximum they have ever produced is 150,000 and we're estimating a need for 200,000 a year.

"5. The same general conclusions apply to other types of equipment. Thus, under the first assumption of full recovery in three years, annual new locomotive requirements would amount to 3,400 locomotives" a year.

Haas: Full recovery is how much?

Currie: Full recovery, 145.

H.M.Jr: Two years - am I right - they made 15 or 25 locomotives. What was it, 15 or 25 - somewhere in there.

White: I think it was 15.

H.M.Jr: It was either 15 or 25 that they made.

White: I have a table on that, yes.

H.M.Jr: It was the most amazing thing.

Eccles: They haven't made any for years here to amount to anything; that's the trouble.

Currie: Now, putting this in dollar terms - "Construction activity in new equipment of this magnitude would require a total annual outlay of approximately

-16-

"\$800,000,000" a year.

H.M.Jr: That's for cars?

Currie: Cars and locomotives and passenger trains, carrying these estimates right through on that basis.

"7. In view of the financial condition of the railroads, and the tendency for orders to be postponed until absolutely necessary, it appears unlikely that expenditures for new equipment of such magnitude will be undertaken in the near future.

"8. Assuming, therefore, the continuance of recovery at a desirable rate, there appears to be a very distinct possibility of a shortage of equipment in 1940, of a bottleneck in equipment making capacity, and of a comparatively sudden and relatively large demand for steel from the railroads superimposed on what are likely to be heavy demands from other industries."

H.M.Jr: Will you read that sentence again?

Currie: "Assuming, therefore, the continuance of recovery at a desirable rate" - that is, a rate that would get us around 125 somewhere in 1940, and then from there on - "there appears to be a very distinct possibility of a shortage of equipment in 1940, of a bottleneck in equipment making capacity, and of a comparatively sudden and relatively large demand for steel from the railroads superimposed on what are likely to be heavy demands from other industries."

And you will notice from the chart, Mr. Secretary, that the steady decline in the railway cars owned since the twenties - it's gone down steadily; even the purchase of the 65,000 cars last year was not sufficient to arrest that decline, because retirements are about 100,000 a year.

H.M.Jr: I'd like to ask a couple questions. I've been sitting in on this airplane business. I think that - if I'm right, that the locomotive people have kept their prices up - I mean whether they sold 15

-17-

locomotives or whether they sold 500 locomotives. I think I'm right. I don't know that they keep their price right up - just about the same, I mean. Has anybody ever talked to the locomotive people - I mean that if they got an order for a thousand locomotives, whether they would really go into production and do something over a two- or three-year basis.

Haas: I did once.

H.M.Jr: What?

Haas: I did once, some years back, and they said - talked to the vice president of one of the companies - the Lima Locomotive ...

H.M.Jr: He represents - they have an association and the President of Lima has been down to see us.

Haas: I talked to him, and I asked him why they didn't do that, and he said the main difficulty was that a locomotive was largely a custom job, that you had a certain - the tracks were not uniform, and even the type of trains they had to haul - in other words, they had to design the locomotive largely, he said, to fit certain situations; but he didn't - that was his argument.

H.M.Jr: That's just like the plane people. But I was wondering if the railroad people could get this down to two or three types - I mean whether then they couldn't go into production on a chain-belt basis and really produce some at a reasonable price.

Eccles: Well, we had last year in a part of the recovery program - we did a good deal of work on this whole question of railroad equipment, and I had several conferences with Wright, who is the R.F.C. adviser.

H.M.Jr: Good man.

Eccles: Yes, very good man. He did some work for us. We also had discussed the matter with Averill Harriman a couple of times, and we had their controller, a fellow that's experienced, to check a lot of our figures and estimates. And as I recall, Currie,

-18-

they pretty well agreed upon this problem; they indicated that there was, of course, a lot of bad-order equipment and there was a real danger of a shortage of equipment. What we were trying to get them to favor, which they weren't particularly favorable to - they came back with an alternative program - we tried to get them to favor a program whereby a Government corporation would purchase the equipment and would - and the railroads would be prevented from buying their own equipment, so far as it could be first furnished by this corporation, the idea being to do just this thing: to place orders for thousands of cars, to try to get the equipment standardized, and thus to place orders at a time when the steel mills and the equipment companies had no business, no orders; and then the equipment would be available to lease to them.

That would, of course, give the Government this self-liquidating project that could be financed outside of the budget through the R.F.C. And over a period of three years it was estimated that at least a billion to a billion and a half could be done in that field.

The whole equipment field couldn't be taken over at once; it would take time, of course, because there was the passenger equipment and certain locomotives - it was felt that most of the railroad freight equipment could be standardized, and also certain types of locomotives, these switch engines - and a certain type could be standardized. We've got a - we've done a lot of work on it, and it ... - however, that's out, and ...

H.M.Jr: Why is it out?

Eccles: Well, it's out unless Congress would set up that kind of a set-up.

H.M.Jr: Why is it out?

White: I think one of the essential preliminaries for bringing it back in again is an appreciation of just this problem. Once it's realized the bottlenecks that would exist, then some proposal to eliminate that possibility comes to the fore, and if they could sift the various possibilities, this one is ....

-19-

Eccles:

Of course, the railroads say this - Wright and this fellow from Union Pacific and Harriman, too, said that you could avoid this trouble if there was a sufficiently favorable loan basis made by the R.F.C.; that there would be a great deal of equipment purchased if it wasn't a question of putting out funds by the railroads; that many of them didn't have funds and those that did were very hesitant at this time to impair in any way their cash position; and that if the R.F.C. would make hundred percent loans, taking the equipment as security, and loan it on a basis of, say, two percent or two and a half, just about what the money would cost the Government, that - and give them, say, "In order to get the benefit of this, you must place so many orders now, so many in six months, so many in six months more" - in other words, the railroads under that kind of a program would come under - would place a good deal of equipment because it would not require the cash outlay. And they contended - and I think it's correct - that the cost of maintaining a great portion of their present equipment - lot of it is old and it's obsolete, it's expensive to operate it, and the cost of maintaining it and operating it is far more than an interest rate of, say, two or two and a half percent and the amortization over a period of twenty years. Therefore, it would actually be cheaper to buy new equipment and scrap a lot of the old equipment than it would be to try to keep this equipment in repair.

H.M.Jr:

May I just ask this a minute. I mean I know a little but not an awful lot about the railroad situation; but I do know about their debt situation, and I mean I wouldn't be worrying about having to get a law that they'd have to buy this or rent this thing first; because if this thing was done and the people had - shops had two- or three-year orders, they could cut their prices so that no railroad could buy as cheaply as this central agency. So there wouldn't be any question - I mean you could cut, most likely, locomotives in half if you gave them enough orders for two or three years.

In this talk that you had - I mean is it - maybe it's all been done - the idea of the Government

-20-

doing this and then leasing this equipment to the railroads?

Eccles: That's right.

H.M.Jr: Was that Currie's memorandum originally? I'm not teasing.

Eccles: It was worked up there by ...

H.M.Jr: Well, I mean ....

Eccles: Don't know whether you saw it or not.

H.M.Jr: Well, I don't want to tease; I saw it, but I saw it in the press.

Currie: Mr. Taylor had a copy of it.

Eccles: Wayne - this thing was discussed with him.

H.M.Jr: Does that need legislation?

Eccles: Yes.

H.M.Jr: Well, why don't you do this? This is what bothers me, and I don't know whether ~~it~~ bothers the rest of you - the thing about this present recovery that bothers me so much is that so much of it depends upon the automobile business. I mean the more you read - I mean, for instance, if the automobile business should go sour tomorrow I'd be worried like hell, and ....

Eccles: And you've got to ....

H.M.Jr: If I may just finish a second now - and to have something in its place, to take its place, why wouldn't it be proper to have this committee develop this thought of a Government corporation to build railroad equipment and lease it? And why wouldn't it be proper - I mean let's divide this up, and as long as you did it before, if the rest are willing, you take it up with Jesse and see whether you can't push this thing, see? The idea of a Government corporation. And, Marriner - and have it sell its own ...

-21-

- Eccles: Oh yes, sell its own debentures against the equipment.
- H.M.Jr: Sell its own debentures. And the life of that equipment is what, about 20 years?
- Eccles: Yes; I think at least the life of the debentures should be. The equipment may be maintained - depends on the type of equipment, of course, and the usage; but debentures should not exceed 20 years.
- H.M.Jr: And I'd like a sinking fund and - I mean write off ...
- Taylor: Of course, regular equipment trust type of obligation.
- Eccles: Amortized installment payment program.
- H.M.Jr: And then have it - I'd talk in terms of a billion dollar corporation.
- Eccles: It ought to be a billion if you're going to do it at all.
- H.M.Jr: Billion dollar corporation. And then do with this - publicize it in advance the way they have done on the utility thing, see? I mean get this out - this committee could get it out as a committee and publicize it and educate the public, and then this thing - again, all of this is in the room - the President doesn't feel that he's going to get any railroad legislation, for this very important reason, that Burt Wheeler is sitting back and taking the attitude "Whatever's going to happen, I'm going to hang this on the President," and the President is very fearful that he can't get anywhere.
- And for you people, if you'd care to see it, Mac and I - which happened to be my idea; Mac worked it out for me, worked out in the greatest detail for the President eight months ago a bill just for a transportation department. If any of you people would like to see that, it's available.
- Eccles: Think it would be very well to see it, Currie, in connection with this study.

-22-

- H.M.Jr: And very ably done. So we have a bill for a transportation department which was worked out here.
- White: The beauty of this procedure, Mr. Secretary, is that it has any number of excellent selling points. The one you mentioned about not being dependent on, not one crop but in this case one industry's prosperity. Second, this proposal, as it could be developed, could fit into that plan or any other plan which the Government saw fit to do with respect to the railroads; it doesn't commit the Government to a course of action which would hamper it in later developments.
- H.M.Jr: Well - and then you can do this; we can be a little bit - slightly intellectually dishonest, we can call this a part of national defense.
- White: Well, that's definitely a part of it.
- Ruml: Perfectly sound.
- Eccles: It's perfectly ....
- H.M.Jr: All right, thank you, gentlemen. Thank you, thank you. I thought I'd rather say it than have somebody else say it.
- McR: You're clear.
- H.M.Jr: I wanted to say it first.
- Bell: Sounds familiar to the Director of the Budget.
- Currie: Right on that point ....
- H.M.Jr: I thought I'd better say it before some of these ...
- Currie: ...the surplus cars this fall, with this very low peak of traffic down here, was not greater than in the twenties, really, which is the absolute - I mean the railroads are just not equipped to handle any decent expansion of traffic.
- H.M.Jr: You know, a month ago you were talking to the Director General of the Railroads, and Danny Bell



-23-

took that title a month ago. Danny Bell took that title.

Eccles: He didn't know it, either, until somebody told him.

H.M.Jr: Yes, I did.

Taylor: Stationery with a locomotive on it.

H.M.Jr: I could have gotten railroad passes and everything.

McR: He refused to use railroad passes.

H.M.Jr: I feel - we had six employees.

Bell: I was Assistant Director General, and as railroad experts we ....

H.M.Jr: You wiped me off on that, didn't you?

Bell: Yes, we closed it up.

Eccles: I don't know of any program that has more selling points than this program has. We haven't even scratched the surface of it this morning, but last year we were prepared for all of them, and I discussed this thing with the President and he was very - he was for it, but he ran right into this problem that you know developed last fall with Wheeler and with the railroads themselves asking for a freight increase.

But it seems to me that if we're going to approach the problem of a compensatory budget policy, it can't be done unless we bring in just this sort of thing, because that after all is what it amounts to.

Haas: That's right. Sweden has those things under their control. Sweden has the big industries, which they expand and contract expenditures, and this is one way of doing it.

Eccles: Without running the railroads, without taking over the obligations of the railroads - you can enter this field in - and in no way assume their obligations, whereas ....

-24-

- H.M.Jr: Well, Marriner, would you carry the ball on this and have something further on it in two weeks?
- Eccles: Be glad to.
- H.M.Jr: Because inasmuch as you all think this is a matter of national defense (smiling), I think we ought to carry it forward rapidly.
- White: And national safety, because the equipment is reaching a point at which accidents will occur.
- H.M.Jr: Would you in doing it - the thought, I mean, that as near as possible standardize the freight car and standardize the locomotive down to several types. I mean that if they need special types, let them buy those themselves, but - in other words, if the railroads - so many coal cars and so many this and so many that - I mean if we could get down to three types of locomotives and three types of freight cars, and we'd specialize in that, and if they need the other stuff - in other words, what I'd like to see is to get out a freight car which would be acceptable to every railroad, and then when one railroad doesn't need it and it's slack, you can give it to another. And depending upon - as the wheat crop moves, the freight car would follow the wheat crop. And keep it down to that sort of thing, so that kind of locomotive could be used almost on any type.
- Then if they get into a highly specialized thing that has to take them over the Rocky Mountains, let them buy those themselves.
- Currie: This corporation could also be used for direct negotiation for the railroads on complete streamlined trains, something like that, built for a long-term lease. Doesn't do away with the possibility of specifications for individual railroads.
- H.M.Jr: No, but I've just - I've sat in on this airplane business at the President's invitation, and I'm more and more convinced that if we can simplify this thing... How many different kinds of tires do we buy for the Army? You remember that time we ...
- McR: I don't know -tremendous.

-25-

- H.M.Jr: It's just perfectly silly. And then we got down to a certain type of tire. I mean it's just perfectly silly, the number of kinds of tires that we buy for the Army through Procurement; it's just asinine.
- Eccles: There would have to be some compulsory legislation on this. The discussions I had indicated that these railroad fellows are as finicky and temperamental as a woman. They have some different little variations in equipment of different companies, because of different foolish ideas, and I think you'd have to have a ....
- H.M.Jr: Marriner, may I just say ...
- Eccles: Go ahead.
- H.M.Jr: ... if you don't mind, I'd rather - if I'm going to have something to do with, I'd as a last resort - let's make it democratic and voluntary. I mean I'd hate to be party to something that's going to force something on the railroads. Let's make it so attractive to them on a price basis that their directors and their stockholders are going to say, "Well, if you can get a locomotive from the Government at \$50,000, why the hell should you spend a hundred thousand?" I mean I hate this legislation which superimposes this Administration on anything.
- Eccles: Well, what you could do, I suppose, would be to lease it on a cheap enough basis ...
- H.M.Jr: ... that they got to take it.
- Eccles: ... that the railroads couldn't afford to use their own funds.
- H.M.Jr: Good old Jesse Jones, who beat me down to a half of one percent for his money. Now, on a 20-year basis, there's no reason in the world why - I mean if we had to raise money - but you're going to sell these things - why these people should pay at the outside more than two to three percent for their money.
- Eccles: No, they shouldn't; they can go out and get money for themselves at three or three and a half.

-26-

- H.M.Jr: But they can't on their own credit. The B & O, for instance, can't do it; but the B & O undoubtedly would be a good customer.
- Taylor: They can do it on equipment trust ....
- Eccles: They can all do it on an equipment trust basis, on an 80 percent trust basis - pay 20 down and the balance is amortized; but the rate is three, three and a half percent.
- H.M.Jr: Would you go into it? But try and not to make it - how shall I say - compulsory on the part of the railroads.
- McR: Don't prevent the railroads from doing what they want to do; merely create a situation where they can't afford to do anything else.
- Eccles: You could do that if you made it cheap enough, if you put the rental low enough.
- H.M.Jr: That's - sure, that's the point. It's the same thing on a housing - your F.H.A. loan; you don't make the man take an F.H.A. loan, but you make it so attractive that he can't afford to take any other kind of loan.
- Eccles: That's right.
- H.M.Jr: Well, will you carry it?
- Eccles: This thing has a further important aspect. It is this: that in times of depression, where the railroads are in bad, having difficulty, you could drop the rate of rental down to a very low point and thus tend to assist them. In times of real business prosperity, when they're making substantial earnings, you could raise the rental charge. So that this could be used as a means of leveling out the earning conditions of the railroads, and would tend to stabilize ....
- H.M.Jr: I don't think you could do that.
- Eccles: ... their income or securities, instead of increasing - what they do now is increase and decrease freight rates to meet the problem, which is the wrong

-27-

way to do it.

H.M.Jr: But in making the study would you also see whether the kind of steel that goes into freight cars and locomotives is in competition with automobiles? I don't think it is, but that's important.

Eccles: I think it's much heavier.

H.M.Jr: I don't think so; but that would be important, Currie.

Currie: Yes.

H.M.Jr: What?

Currie: Yes.

H.M.Jr: I think you'll find it's a different kind, because there are certain of these mills now running at a hundred percent - I understand Inland Steel is running at a hundred percent on sheets for automobiles - their capacity. But I'd be interested to see whether some of the other units which go into locomotives and cars ... And of course, it would use a lot of wood too.

Currie: That's true.

Eccles: We'll make this study, but there is this alternative, which doesn't involve legislation, that would help to meet this problem. And that would be that the R.F.C. would offer them a hundred percent loan, which there is no legal reason why they can't do, and then can loan it at two percent; they in other words could induce the railroads today to go out on a very large scale and anticipate or buy equipment. That is, assuming of course that you don't want to get legislation or if you can't get legislation, still we can do a lot toward meeting this bottleneck situation.

H.M.Jr: May I make two others?

White: Except that this is one of the best cases which you might be able to sell Congress. It has so much to speak for itself that it is an excellent beginning in that type of operation.

-28-

- H.M.Jr: May I make two other suggestions? One, that if we have this kind of corporation it would be set up, Mac, with a little board, the board on the same basis that we've set up Commodity Credit as a model. I'm the only stockholder in Commodity Credit, but the board goes ahead and functions, and they have all the authority. In other words, I'd like to set this up so that if there is a railroad administration it would be taken out of the Treasury and transferred right there; we'll give it up like that; but if it's some other independent agency, they might hang on to it a little longer. See what I mean? What I'm trying to say is, I wouldn't put it in R.F.C., and if we have it here simply with myself as stockholder, but with this board functioning purely independently, then if you get a railroad administration, why, that can be - and if you look at that bill you'll see how we can do it - that thing can be transferred right over to the railroad administration. But leave it here as a resting place until you have it. But my own inclination is, I would not put it in R.F.C.
- Taylor: Probably keep the stock here anyhow.
- H.M.Jr: What?
- Taylor: Probably keep the stock here anyhow.
- H.M.Jr: Marriner, if you look at how we set up Commodity Credit, we think that's a model.
- Eccles: The R.F.C. furnishes that money, don't they, for Commodity Credit?
- Taylor: No, the market does.
- Eccles: I know, but what I mean - does ....
- Taylor: Once in a while the R.F.C. eases them over a spot, but they do their own financing.
- Eccles: What I meant was that to the extent that the R.F.C. needs to come in, the R.F.C. has sponsored and furnished the money in the first instance for Commodity Credit.
- H.M.Jr: Yes, but they don't control it. It's not controlled - we've changed it; it's not controlled .....

-29-

- Eccles: The stock of it ....
- H.M.Jr: The stock of it is here.
- Eccles: It's held here instead of R.F.C.
- Taylor: Yes.
- Eccles: Was it originally the R.F.C.?
- Taylor: You had a rather peculiar situation in which there was stock scattered between the Secretary of Agriculture, Farm Credit Administration - who was the other one?
- Bell: Mr. Hull, wasn't it?
- Taylor: Not on Commodity Credit, was it? He may have been in on that too. There was a minimum of common stock, you see; then they built up this big R.F.C. holding when they increased the capital to make up for the losses. In addition to that, the R.F.C. financed them through borrowing, and the R.F.C. in turn got the funds from us. But that's all been washed out in this new legislation.
- H.M.Jr: Wayne worked this out. He's largely responsible for this, and I think it's a good model. And all we do - we hold the stock. And as I say, the beauty of the thing is, the directors are made up of representatives of Agriculture, Farm Credit, and R.F.C., but nobody controls it; nobody controls it.
- Eccles: This would likely be, in order to get the lowest possible rate - to be able to rent this equipment at a price that would be a great inducement, likely would have to have a guaranty.
- Taylor: Have to sell it with a Government guaranty, just the way we sold Commodity Credit debentures.
- H.M.Jr: What I'm getting at, Marriner, is that we haven't been very lucky in getting Jesse to do this kind of thing, and if we're going to do this thing, set the thing up so it will go to town - and I think we'll get further, that's all, if ....

-30-

Eccles: Well, I agree with you a hundred percent.

H.M.Jr: And it isn't - if you study the thing, it isn't that - I don't control Commodity Credit, it's controlled by the representatives of Farm Credit, Agriculture, and R.F.C. They run it.

Eccles: The structure is a lot simpler, after all. Anyway, why have the Treasury own stock in the R.F.C. and then the R.F.C. have stock in another corporation? You're building up a super-holding company. So why not have the Treasury hold directly the stock?

Taylor: That's what we were doing; and this is, we think, a model that should be applied to all the rest of them, not only the existing ones but any which may be created in the future. And over a period we're going to try to get the other ones adjusted to this model.

Eccles: Well, I think it's all right; I'm for it.

H.M.Jr: I think it is. The only reason I'm stressing it is that if it's set up that way and the President wanted it, and the rest of it, I think we could go to town on it - and Congress wanted it; and we wouldn't have - well, as I say, it's the record of Jesse that he says he'll lend a hundred million and then he lends ten million.

Taylor: He's loaned plenty to the railroads.

H.M.Jr: Well, will you carry this and come in in two weeks with something?

Eccles: Yes, all right.

Currie: Mr. Secretary, I think it would be helpful in this thing if we could get in touch with and get some support from the Army people on this national defense, just as we did on the power program.

H.M.Jr: Well, whatever Mr. - whatever Mr. Eccles wants; it's up to him.

Taylor: You won't have any trouble getting support for this at this time, Marriner. Last spring, why, it was a



-31-

little more clouded, but I think now, why, the time is much more propitious for it.

Eccles: It's like everything else. It was too new; they hadn't digested it.

H.M.Jr: I don't like to lean so heavily on the automobile industry.

Eccles: Well, certainly if the railroad industry and housing do not continue to go forward on an increasing scale, the automobile industry is likely to bog down. The one thing that will tend to maintain the automobile industry would be to - this sort of a thing has not only the effect of giving employment within this particular industry, but the fact that it gives this employment is going to help to sustain and maintain the automobile industry and it will help to push housing because it will help the whole problem of employment.

H.M.Jr: It's all to the good.

White: One of the studies just completed by the National Resources Board supplies a factual basis for that statement rather clearly; it shows a fact we have all observed, how the automobile industry responds most quickly and is most sensitive to changes in national income. So what you say has that to support it.

H.M.Jr: Do you feel all right on this, John?

Hanes: Yes, sir; good, fine.

H.M.Jr: All right. See anything the matter with it?

Hanes: No. I like it.

H.M.Jr: All right?

Hanes: Yes.

H.M.Jr: All right. Does that clear that up, Marriner?

Eccles: Yes, that's satisfactory to me. I think we can - do you see any reason, Currie, why we can't have the

-32-

staff specialize in this field for the next two weeks?

Currie: No.

Eccles: Bring together and dig up all the material we got last year; revive it and shape it up for a meeting.

Taylor: You're 90 percent in now, with the stuff that you did last year.

Eccles: We've got a raft of stuff on it.

H.M.Jr: All right. Two weeks?

Eccles: All right.

Taylor: I can work on that with you; I can give you this Commodity Credit set-up.

Currie: Fine.

H.M.Jr: Is that - anything else on bottlenecks?

Currie: There's just one other point, Mr. Secretary, and that is that I haven't done any work yet on the power industry - I thought that would be the next thing to turn to - but this chart I had made up for another purpose indicates, I think, the possible seriousness of it. I put capacity, output, and capital expenditures on a base of 1929 equals 100; they're all index-numbered. So that means not that capacity - that your output was up to capacity in '29, but that was the relationship in '29. See, we're back in '37 - we got back to the 1929 relationship, and we're almost back there now, because power is recovering again and we're not adding much to capacity this year.

H.M.Jr: Isn't there a committee on that - Louis Johnson... ?

Currie: I believe there is.

H.M.Jr: Is there anything we ought to do on it?

Currie: I don't know - unless we bring it into our general study on bottlenecks.

-33-

- Bell: A national defense program, - I don't think it goes to the commercial end of it.
- Eccles: It doesn't make any difference whether it's battleships or power, what it is, it all has an influence on this question we're dealing with - that if you're going to have this power situation deferred, its development deferred to a point where then it's a rush job to try to get equipment and build power facilities, it's just like building railroad equipment all at once..
- H.M.Jr: Well, if you listen - excuse me - if you listen to Louis Johnson, he's got it all done. But why not ask him?
- Eccles: Well, I think we ought to point out the danger of bottlenecks wherever they are.
- H.M.Jr: Do you want to find out what they have done?
- Eccles: I think we ought to do it, Currie. After all, we can't study the question of bottlenecks ....
- H.M.Jr: ... unless you've got all the bottlenecks.
- Eccles: Yes - where the possible problem is going to develop.
- Currie: There is one little sour note, Mr. Secretary; that was in the press report of that conference after you left the White House, in the Times - that's all I know about it - to the effect that some of the utilities privately expressed the view that this was really work they were going to do anyway.
- H.M.Jr: Well, Hanes knows something, if he'll talk.
- Hanes: Well, I don't know who made that statement, but my understanding is that that was not a true statement nor was it the opinion of the people that attended the conference; that they said they would not have spent anything like this sum of money - by 500 million dollars, I think they said. So whoever made that statement, they say - Grosbeck said it was a misstatement of the fact. I saw that too, the same thing you were talking about, and I asked him about it immediately.

-34-

H.M.Jr: Well, aren't they asking for legislation too?

Bell: They will, I think.

H.M.Jr: Yes, they need legislation.

Eccles: Who is it, the Power ...

H.M.Jr: The Power Commission.

Eccles: It's a problem of equity financing to quite an extent with the power people, as well as, of course, an understanding with reference to their legal status.

H.M.Jr: Didn't they ask ....

Eccles: Jones came out and said he would underwrite it up to 250 million dollars.

H.M.Jr: I think they've done it, but why don't you ask them, Marriner, what they've done?

Eccles: All right.

H.M.Jr: Louis Johnson will tell you, maybe.

Eccles: No, I'll talk to Woodring, I guess.

H.M.Jr: No, Johnson is chairman of that.

Eccles: Yes, I see. It isn't really a War Department thing, it's a special committee, isn't it? He simply heads up the committee.

H.M.Jr: That's right.

Any other thing? Anything else on bottlenecks?

All right, that sounds encouraging.

Eccles: We're going to study this, the question of bottlenecks, in housing, in the construction field. We haven't anything on it yet, but it's something that I think we ought to begin to think about; because you can't get anywhere near a normal volume of construction

-35-

without running into bottlenecks at least in the labor field.

McR: Skilled labor.

Eccles: That's right. Unless the labor people are willing to start letting apprentices in and increase the number of people they will take into the unions and not continue the cutting of hours, you will run into bottlenecks in the construction field with seven or eight million still unemployed.

Taylor: Got them right now, haven't you?

Eccles: Not yet; haven't got any bottlenecks yet.

H.M.Jr: Well, Marriner, will you continue this stuff?

Eccles: Oh yes, we'll continue it.

H.M.Jr: All right. Now - is that all, Marriner?

Eccles: Yes, that's all, all I have today.

H.M.Jr: Well then, "Effect of budget items."

Ruml: Following our meeting last time, Mr. Bell and I had a conference. We had, if you recall, from each - from the Treasury, from the Federal Reserve Board, and from the Federal Reserve Bank of New York, a rough classification of the various budget items in terms of their effect on the national income.

Following this meeting that I had with Mr. Bell, I had assigned to me a man from the New York Bank who is here today conferring with one of Mr. Bell's men on the accounting side. I have a preliminary report from him - from the Federal Reserve Bank, and I think that at our next meeting it's going to be possible to get these concrete illustrations, Mr. Secretary, that we're talking about.

And the way I'll set it up is this. I'm going to try to take the 1937 budget and the 1938 budget, set them up realistically from this point of view, and see how they look. I don't know how they're going to

-36-

look, but the first stuff I've got makes me believe it'll be some rather dramatic information.

H.M.Jr: You mean you're going to give us some concrete examples as to what equals X?

Ruml: That's it exactly.

H.M.Jr: And you're going to do that?

Ruml: Mr. Bell and I are doing that; rather, our assistants.

Haas: The coefficient effects are really important.

Ruml: That's right.

H.M.Jr: But you're going to give me something to put my teeth in.

Ruml: Yes, sir.

Bell: I didn't have anybody that was qualified to study these expenditure figures as related to economic conditions. I have plenty of people to explain the classifications and get out any kind of statement that's wanted. So Mr. Ruml asked Mr. Harrison if he wouldn't loan Mr. Sanford for a week or so. I think some of these classifications you could probably argue about, and when you come to putting them in different groups, it's just a matter of opinion, and I think on the Federal Reserve set-up probably the lines are pretty finely drawn. I question whether you can separate payments to WPA workers and compensation payments to veterans, or even the salaries of Government employees. I think that again that's just a matter of opinion, and if you get together you'd probably have to - instead of having five classifications maybe you'd have three, something like that. ....

White: These differences do exist, Mr. Secretary. It's merely a question of arriving at a composite estimate in which you can put in these various classes what everybody reasonably agrees on, and what remains is in the doubtful group. But the mere fact that it may be difficult to allocate

-37-

particular expenditures merely means that more study is called for, not that the classes do not exist.

H.M.Jr: All right; then we'll wait on that patiently, with my tongue hanging out.

Ruml: We're working on it.

H.M.Jr: All right. I don't want to bite my tongue off.

"5. Effect of operations outside the budget."

Ruml: Well, we have already discussed the railroad matter. I don't know whether ...

White: There's several others. There's the toll roads, which has been brought to a - been pushed pretty far, lot of work done. It's in the form of a memorandum. I think it's probably too long to be taken up this morning - been prepared - but we'll have it next time.

H.M.Jr: Can you get it down pretty brief?

White: Can get it down for next time.

H.M.Jr: President pulled a good one on Johnny Hanes. Hanes came over with a sheet of paper about twice the length of this, as to possible sources of tax revenue. The President said, "Well, Johnny, I said - I hear you've heard about it - I always insist on one page; but what a page!" It was about twice as long as this. He said, "That's a new one." Right?

Hanes: That's right.

H.M.Jr: So, Harry, if they can get it on a page ...

White: They'll try.

H.M.Jr: It doesn't have to be the standard size.

Now, "Flexibility - Income, Expenditures."

White: There were two other - there were several other projects which will come along also in the same category; but toll roads was most nearly completed.

-38-

- Currie: I've had the boys this week make a survey of existing possibilities without going into new activities, which we have a report on.
- H.M.Jr: Well, may I just - I'll get it when you talk toll - you (White) also talk toll bridges, of course?
- White: Yes, but that was outside of the present budget set-up. Currie is now speaking of possibilities within the present budget.
- H.M.Jr: All right, you got something on your mind?
- Eccles: Well, we've got a report. I don't know whether you want to go into that or not. It's a preliminary survey of the possible expenditures that can be made outside the budget....
- H.M.Jr: Well ...
- White: .. now included within the budget.
- H.M.Jr: Think we ought to do it or think I ought to read it, Marriner?
- Eccles: It isn't long - a couple pages here.
- Bell: Let him hit the high spots.
- Eccles: Go ahead, Currie, hit the high spots. You can read that, I think.
- Currie: This is really just a summary of a long memorandum which contains the findings in very rough terms.
- First finding is this: "Over \$1 billion of guaranteed debt might be substituted at any time for public debt, if suitable administrative and legislative action were taken." And then under that: "(a) The R.F.C. has \$600 million of borrowings from the Treasury which it could retire by issuing its own debentures."
- H.M.Jr: Well, that's in the works.
- Taylor: In process of being done.
- Currie: That requires no legislation.



-39-

"(b) If new legislation were enacted, another one-half billion dollars of direct public debt might be retired by issuing guaranteed bonds against existing assets. The R.F.C. might retire part of its capital stock" - that is, its earned surplus, two hundred million dollars - "and the HOLC might take over shares of savings and loan associations owned by the Treasury. Assets of the emergency crop loan program, assets of the rural rehabilitation program and assets that have been transferred to the U. S. Maritime Commission might form the security for issues of newly authorized bonds or notes of Federal agencies. Any such immediate reduction of the public debt would be at the expense of a corresponding reduction in later years."

That's on what could be done in shifting at any time. Now, if we had enabling legislation "II - Expenditure programs now in existence or contemplated to the amount of some half billion dollars a year might be financed without the use of direct public debt, providing suitable administrative and legislative action were taken.

"This conclusion rests on the following considerations:

"(a) A number of Federal corporate agencies, whose capital stock is owned in whole or in part by the Treasury, will automatically continue to make loans largely without further use of the direct public debt. Among these are the United States Housing Authority, the Commodity Credit Corporation, the Federal Home Loan Banks and the banks and corporations of the Farm Credit Administration. The one of these which will clearly be expanding its assets steadily is the United States Housing Authority; its loans, to be financed with guaranteed bonds, may reach a total of \$150,000,000 by next June and may increase by another \$300,000,000 in the following fiscal year."

H.M.Jr: Excuse me - get somebody, Marriner, to give you the Treasury's position on United States Housing bonds. Ask Wayne to give you that.

Eccles: On the tax picture?

H.M.Jr: The reason why we don't want them to sell the 90 percent local is because they're totally tax-exempt; that's

-40-

the whole story.

Eccles: I know that one.

Taylor: There's another important reason.

H.M.Jr: Will you give him that?

Taylor: I'll give him a copy of the letter that wasn't sent.

H.M.Jr: We wrote a letter, and Straus has asked us not to send it until we can think of something better. That'll be the best way.

Currie: "(b) If the R.F.C. undertakes to finance all its further loans by issuing guaranteed notes, a loan expansion which might amount to anything from \$50,000,000 to \$250,000,000 could be financed without instead of with the use of direct public debt. This would include loans to municipalities in connection with the P.W.A. program, loans to railroads, loans to public utilities, and loans through the R.F.C.'s subsidiaries, the Export-Import Bank, the R.F.C. Mortgage Company and the Federal National Mortgage Association.

"(c) If suitable legislation were enacted, certain other expenditure programs already in existence, which may run from \$100,000,000 to \$200,000,000 a year, might be financed without instead of with the use of direct public credit. The most promising of these programs for this purpose include Rural Electrification loans (now financed partly through the R.F.C.), F.C.A. emergency crop loans, Bankhead-Jones farm tenant loans, Farm Security Administration rural rehabilitation loans, and U. S. Maritime Commission ship construction.

"III - The possibilities of shifting any substantial part of current budgetary expenditures to self-financing agencies appear limited. However, an extension of certain activities of the Government through self-financing corporations would lessen the necessity for other large and continuing budgetary expenditures such as work relief and public works. Thus a shift of certain existing programs to a self-financing basis plus an extension of Government

-41-

activities that could be so financed would permit, either directly or indirectly, a budgetary balance to be attained more quickly, yet with no more danger, than is now possible."

- H.M.Jr: Can I have that?
- Currie: Yes. (Hands memorandum to H.M.Jr)
- Taylor: We've got a lot of work done that's corollary to that.
- H.M.Jr: I know; this is not so easy.
- Eccles: Well, this is just a preliminary sketch of it; and each of these would require a good deal of thought and study, and we just got a lot of this stuff in the mill, so that ...
- H.M.Jr: Well, without handing this committee any bouquets, I think if the work last spring had been done in this very careful manner - I don't think the President and Bell and Hanes and I would be having such a headache now about the unexpended funds which are going to be carried over to next year and what the hell we're going to do about it. I mean that's the thing that's the headache now - when you see the money which was voted and isn't going to be spent this year.
- Eccles: No timing. I say the timing was terrible, wasn't it?
- H.M.Jr: What?
- Bell: If this is going to be done ....
- H.M.Jr: Well, the timing, yes - 24 hours - huh?
- Eccles: Yes. ....
- H.M.Jr: 24 hours.
- Eccles: You appropriated this money last year with the idea of having it expended, and it was done in a way that it isn't expended, and therefore it didn't work out in accordance with the timing schedule.

-42-

H.M.Jr: And that was my fight which I lost.

You (Ruml) want to say something?

Ruml: No.

H.M.Jr: Bell?

Bell: Just going to say, if these suggestions of Currie's are going to be adopted, we certainly would want to follow literally the Commodity Credit set-up, because you've got many organizations in there whose assets you cannot carry on the balance sheet at full face value, and you'd have to write off some of them every year, and those write-offs ought to appear in the budget as expenditures, just the same as the losses of Commodity Credit.

Taylor: Should be done anyhow.

Bell: Yes, of course, it should be done anyhow. Today they are carried as expenditures. Take the crop loans; you only collect an average of 65 percent of face value, and you lose interest on all your loans at the same time. Same way with your tenant loans; have to write off every year, it seems to me, at least 35 percent of them, to keep your budget on an even keel. Otherwise, ten years from now you're going to have to write off a whole lot ...

Eccles: But if each of these outfits were put on their own feet, with the idea they'd have to try to operate and collect - and to the extent they couldn't, then naturally it's a loss and it would have to come out of the budget. But you'd know each year just what it was and it wouldn't come all at once, like it does now; it would come at the time the loss was incurred.

McH: The selling point to Congress, I think, Murriner, will be the very fact that under the Commodity Credit form of set-up you've got to go back to Congress every year to make up your losses, so Congress is really passing on it and it becomes a budget expenditure. Perfectly sound.

-43-

H.M.Jr: Naster, will you have a copy made of this memorandum and give it to the people here who are not connected with the Federal Reserve. We can do it.

Currie: I have three more here.

H.M.Jr: Well, that would be enough. Mr. Ruml hasn't got one.

Ruml: I should like one very much.

H.M.Jr: Give Mr. Ruml one.

Does that finish that, on this timing?

Ruml: The flexibility matter - I think Mr. Haas has had some conversations with Mr. Oliphant.

Haas: The question was raised at the last meeting whether the President could be given power by Congress to lower taxes or possibly raise taxes, whether or not it would be constitutional for Congress to grant such power to the President. I talked to Oliphant about it and Oliphant says, yes - they couldn't - the Congress - could be worked out this way: that they couldn't grant the President power to raise taxes, but Congress could put it this way, that under a specified condition the President would be instructed by Congress to raise or lower taxes. And then all the President would have to do is to make a fact-finding as described in the act. In other words, I mean - take a simple case: say the index went - or some index or some condition exists, and the President would have an investigation made, and he says, "I find this condition exists." Well then, once he finds that that condition exists, he's obliged to make a change in the tax, up or down, depending on how the statute is written.

And Mr. Ruml is interested in having concrete examples worked out, and he suggests that we take this question of Social Security payroll taxes, which are automatically expected to rise. And I'll see if Herman can do that, have it in the next meeting, if they're interested.

H.M.Jr: Yes. Good.

-44-

- Ruml: On the expenditure side it is important, I think, that pretty soon a determination be made - I talked to Mr. Bell about this last time - as to a method of getting the engineering planning done on a lot of small projects. I think enormous effects can be achieved there providing the planning is done; but it's a question of some administrative determination as to how the set-up of that kind of thing should be done.
- H.M.Jr: We have an administrative expert here (nodding at McReynolds).
- Bell: The National Resources Board has just come out with a very large volume of public works, both large and small, I think. Of course, the plans haven't been drawn, but there are suggestions for public works, and the different departments could do some preliminary work on planning.
- Ruml: There are really great opportunities ....
- H.M.Jr: Well, what'll we do with that, Dan?
- Bell: I should suppose that was a study for the National Resources Committee. And the contacts with the administrative officers ....
- Ruml: You mean make some proposal as to how it should be done.
- Bell: Keep in touch with it.
- Ruml: I don't think the Resources Committee ought to do the planning.
- Bell: I don't either.
- Ruml: But we might make an administrative suggestion in two weeks, Mr. Secretary.
- H.M.Jr: Well, I just want to say one thing, see whether you're all in agreement. Now, the President has, so to speak, launched this publicly. Naturally, the newspaper men and the columnists and letter-writers and everybody else are going to buzz everybody as to what we're doing. I think as far as we're

-45-

concerned, if you people agree, that we oughtn't to tell them anything; and when we do decide something, that we take it over everybody's signature to the President for his use and disposal, and that pending what he wants to do with it, we'll simply tell the newspapermen and so forth and so on, "I'm very sorry, we're doing this for the President; if and when we have something, we'll send it over, and it's up to him to do what he wants with it."

Eccles: We've told everyone that has made any inquiry that you were the Chairman of the committee and if there was anything to be said or given out, they'd have to look to you for it.

H.J.Jr: Well - well, I'm not going to give out anything.

Eccles: And you can tell them that it will have to be given to the President then.

H.M.Jr: I'm going to tell them this is the President's committee and anything we do here, if we come to an agreement or find any recommendations, will be over all our signatures; it will go to him and it's his property, White House property. I mean I'm not going to tell anybody anything.

Eccles: Well, I think that - I think that's right. As a matter of fact, I don't know right now what the dickens you could tell them. It's one of those things that's in the process of development, and the less said the better.

H.W.Jr: But they've been doing a lot of buzzing, a lot of burrowing; I think we've all got to keep a united front and tell them nothing.

If there's nothing else, I just wanted to say this, which is a little bit outside; I just wanted to give you a little of the headache that Bell and I have. It's fiscal and monetary in the sense that it might be quite a shock, but it's the President's business also. But it's in the offing and we're doing everything Bell and I can possibly do; but we're worried like hell. As I say, if what we've been talking about

-46-

before is confidential, this is triple-confidential. Bell and I on October 10th asked Aubrey Williams to come over with his finance officer, and at that time we drew his attention to the fact that they were spending more money than Congress had allotted to them. The way the bill was originally written, they were allotted money for seven months. They asked for money for eight months and they compromised by giving them 175 million dollars which could be spent if the President declared a national emergency.

We pointed out to Aubrey Williams - Hopkins, as far as we knew, was not in town, although we subsequently learned he was in town; we didn't know about it - that they were breaking the law; and we asked them whether we should write a letter to the President or they would, and they told us on that day - I've got my notes all here - that they would notify the President and that the letter had already been written. And then Williams said, "Well, this is so important, I think we ought to see Mr. Hopkins," and we told them that any time Hopkins came over we'd be delighted to see him.

And we had a long thing - and fortunately I had a stenographer present - and both Bell and I warned them that it was a very serious situation, they were using - eating up this 175 million dollars illegally. So Williams went over on the 13th, without Bell or my knowing anything about it, and saw the President, which was perfectly all right, and as a result of which the papers the next day carried the statement "Roosevelt Warns WPA To Stretch \$700,000,000; He Tells Williams Funds Must Last Until the First of March." And then Williams made a statement as follows: "The President told me that the balance at hand will have to last until March first," - "said Mr. Williams, discounting persistent rumors that Congress" so forth and so on.

Well, again feeling that Bell and I - our obligations - we brought it to the President's attention, I think, at least three times, that each successive week to this statement, the WPA rolls went up, and in a manner which I don't know - I don't know how they did it - the WPA rolls for the next month were never released to the public; the figures were never given out, they were suppressed. And when this thing came



-47-

up again last week - Bell is charged with the responsibility - you stop me any time, you tell me ... He's charged with the responsibility of apportioning this money.

Bell: Go ahead, you're right.

H.M.Jr: And, for instance, for November, Hopkins only asked for 125 million - is that right?

Bell: For the month of November he put down as a figure or obligations 123 million dollars.

H.M.Jr: And you said you know damn well he'd spend 200.

Bell: That's right. I refused to approve that apportionment.

H.M.Jr: Bell has a legal or moral - I guess legal responsibility.

Bell: That's right, it's legal.

H.M.Jr: And I have none other than my interest in the whole picture, particularly the unemployed. And the situation that we have arrived at is that the President has refused point blank to sign this, declare a national emergency, and he says he won't do it, as a result of which Hopkins told him Friday that he's going to lay them off.

Now, we've made a rough estimate, Bell and I, that if he does lay them off it means he's got to lay off a million people - now! And Bell and I have done everything possible - I mean our record - thank God, I've got the whole thing here in the book, it's all there - we've done everything, we've gone the limit - I mean other than being discourteous, and it's a matter strictly between Hopkins and the President and the Director of the Budget.

But I wanted - not that there's anything anybody can do, but you're meeting here, discussing fiscal and monetary matters, and here this thing is in the offing. And I say if the other stuff is confidential, this is triple-confidential. I just want to let you know. And have I told the story accurately, Bell?

-48-

Bell: Yes, very well.

H.M.Jr: Do you want - is there anything .... ?

Bell: An excellent job.

H.M.Jr: I mean have I minimized or exaggerated?

Bell: No, sir.

H.M.Jr: John, you've been in on some of this.

Hanes: That's just exactly what's happened.

H.M.Jr: What?

Hanes: You're right. Just exactly what's happened.

H.M.Jr: I just - all I'm trying to do is, I want you to know so that you don't say, "Well, for heaven's sakes, why didn't Morgenthau tell us about this, why doesn't he have confidence in us?" I mean the possibility of such a thing would so disrupt the national economy, I think, and I hesitated - I felt either we're partners or we're not partners, and I figure we're partners, so I'm telling you this terrible story. And Dan and I have just absolutely gone the limit; and the President Friday told him in my presence at Cabinet, "I will not sign that thing."

Eccles: Well, does that - does it mean that Hopkins has spent so much ....

H.M.Jr: Do you mind directing it to Bell?

Eccles: Yes - that Hopkins has spent so much money now in the past that in order for him to come within the funds available, he has either - he's got to cut it down from now until the first of March, say, a million people, or the President has got to sign this, declare an emergency and make available this 175 million?

Bell: That's right.

Ruml: And has he until the first of March to get the million off or must the million go off on the first of December?

-49-

- Bell: Must go off very quickly.
- McR: Today.
- Bell: If he carries on his present rolls, he'll be out of money by January 1.
- White: How much will that 175 million take care of, Danny, if that were signed?
- Bell: Well, the 175 million would take care of about - the whole 1939 program was based on an average of 2,800,000 people at about 175 million dollars a month, see?
- White: So that even if the emergency is declared, he still is behind.
- Bell: He is still behind a little, but if the emergency is declared and if he reduces his rolls probably five or six hundred thousand - these are very rough figures - he probably could get by to January 31.
- White: If he reduced them now by five hundred thousand at once.
- Bell: At the time we had our conference with the President, I believe that if Hopkins had stopped taking on additional employees and just allowed the turnover to reduce his rolls gradually, he could have gotten by January 31 with 175 million dollars. But the President would have had to declare an emergency. And the reason the Secretary and I took it up with him - one of the reasons was that we thought if the President had to declare an emergency, that the emergency was in July, August, and September, and not in January and February.
- H.M.Jr: He could have tied it up with the New England flood.
- Bell: That was the time he should have declared the emergency.
- eccles: He could, of course, now say that because of the flood and other conditions, why, they're going to run short after all.
- Bell: Everybody's forgotten about the flood, of course.

-50-

- Currie: Actually this is going to create an emergency.
- Eccles: Well, this is a matter - when you talk about timing, this goes right square to the heart of the thing.
- H.M.Jr: You fellows don't know what Dan and I have gone through here in five years and why I'm an old man. I mean it's things like this that just make you - aside from everything else, makes your heart bleed. I mean it's just - it's just the human beings at stake - I mean forget the economy of the country and everything else. And I've got the record here, and nobody, without being disrespectful, could go further than I have - I mean without being - to the President, I mean.
- Eccles: The railroads won't need any equipment and the automobile business will be on the - just let this thing start down now, which it well can do, because between now and spring is a crucial time; it is always a time when the unemployment problem is the greatest, even in normal times, and to accentuate that right now, it seems to me, would be just criminal. We can lose all the effect of what has been spent for the last six months through this bad timing.
- White: Picking a million men off the rolls ....
- Eccles: I think if the President's appointed this committee, that he should be - we should make a special report on this particular situation. I'd like to get into the record on it.
- H.M.Jr: Well, I'm open to any suggestions. I'm open to any suggestions. Aren't you, Dan?
- Bell: Yes, sir. I think aside from all the points that Mr. Eccles raises, I don't believe the President can order a million men off the rolls, with winter starting, from the human side of it. You can't do it.
- H.M.Jr: Well, again without wanting to be disrespectful, I've seen him before talk about getting his Dutch up, because he is Dutch, and I don't know why - I don't understand it. After that meeting Hopkins was at - immediately after that - let's see if my records are

-51-

right: following this meeting, Hopkins spent a full week with him at Hyde Park - a full week. He lived at his house for a full week, so there was ample time to discuss the thing. I mean they were together - they were together for a full week, and - but as I say, if anybody has any idea ...

Waite: Isn't there an alternative course of action that this committee might attempt to devise, which might take the form of speeding up expenditures to a very large amount during the next few months, and make it possible for him not to declare an emergency and yet not have that increased unemployment. I don't know, but it appears to me this would be an appropriate committee to examine the possibilities in that direction.

H.M.Jr: Harry, this is like so many Treasury problems; we've got a pistol at our head. This is a 24-hour thing; I don't know when Harry's going to move on it.

Suml: Mr. Secretary, I take it some items were appropriated by Congress which have not been spent - is that correct - some things that didn't get started as fast as was intended?

H.M.Jr: Oh well, I'm not telling anything, Dan, when I say there's 60 percent of the Ickes money been carried over to the next fiscal year.

Bell: As case I think that's approximately right.

H.M.Jr: 60 percent of the Ickes money will not be spent this year. It may be 55 or 65, but roughly 60 percent of the money given to Ickes will not be spent in this fiscal year.

Suml: Well, isn't then that the real problem of finding a psychological way of making the term "emergency" palatable? And I wonder whether the emergency doesn't arise due to the failure of these human plans, like many others, to balance out exactly the way they were intended.

H.M.Jr: You mean you want to get out and say that because Mr. Ickes didn't spend his money as usual, we'll declare a national emergency or national holiday?

Suml: That's the fact.

-52-

- H.M.Jr: Well, Christ, that's what I went through last year. The statement I made last spring was that Ickes was a damn good honest jockey, but he's come in last every year for five years, and why put your money on him?
- Ruml: It simply occurred to me that the speed with which something has to be done is so great that you can't develop an alternative program, and that if some way can be found to indicate that at this time we find that the balance as between one item and another recommended last April was not arithmetically correct, and therefore this thing is ...
- H.M.Jr: All right, I'll tell you, maybe out of my telling, my confession, maybe we could give him a letter and let him hang it on us as an excuse for declaring it. I mean we give him the reason. "Based on the recommendation of my fiscal and monetary committee, who advise me as follows, I hereby declare a national emergency."
- Ruml: We could point out the unbalance of the whole program.
- H.M.Jr: I'm willing to be the ...
- Eccles: Yes.
- Ruml: We could point out that some of the items have not been spent, others have been spent.
- White: Make a very strong supporting letter which would follow that.
- H.M.Jr: If we did this, I wouldn't want anybody to know about it who is not in the room. I don't want anybody not in the room now to know a single thought about it. What do you think about that, Dan?
- Bell: I think that's all right.
- H.M.Jr: But you fellows better come back at 4:30; I mean this isn't something that can hang fire. This isn't something ....
- Eccles: We better take responsibility for advising him on it. He just told the world he's appointed us, and it would

-53-

be a fine thing to have this - within thirty days after he appoints this committee, to have things bogging down.

- H.M.Jr: Well, maybe out of this, as I say, we could draw up a recommendation, say, "This has been brought to our attention and we feel that in view of the following facts you should declare a national emergency," and then give him a draft of a letter which he could use.
- Taylor: And give him a couple charts.
- H.M.Jr: Well, whatever you want. But when does he get to Warm Springs?
- Bell: Tomorrow night, I think.
- H.M.Jr: (On phone) Ask Secret Service when the President arrives at Warm Springs, please. Let me know right away.
- White: Certainly be fitting for this committee to make a recommendation; in fact, one could go further and say it would be very derelict in its duty if it didn't make the recommendation.
- Eccles: That's right.
- H.M.Jr: Up to this point Danny and I have done everything we could do without being disrespectful. We couldn't go any further. And we've worked out, as I say, with Williams - Hopkins didn't see fit to come to see us - and with the President; but we have at least three times subsequently to that shown the President the increase in the rolls each week.
- McR: The one thing you overlooked in telling the story is that WPA hadn't said anything to the President about the necessity for declaring a national emergency, when you had that first meeting.
- H.M.Jr: That's right.
- McR: The only condition or the only - the thing that made them decide that they would tell him was because the

-54-

boss sat here and dictated a letter to the President in which he was telling him himself; then they said, "I guess we better tell him."

- H.M.Jr: That's right; in other words, we forced the issue. Nobody could have done more than Dan and I have done. And not that we want to make a record, if you know - it's a hell of a lot of difference - we're not trying to make a record, we've been trying to accomplish something.
- Bell: well, we weren't trying to force Harry Hopkins to throw off a million men. Don't get that impression. What we were trying to do was keep the President's skirts clear and not wait until February to declare an emergency that happened in July and August, which I don't think he could have put across with Congress.
- H.M.Jr: Well, if the President declares a national emergency now, Dan, that gives Hopkins a chance to go up the first ten days in January and get 900 million dollars, whatever he needs, to carry on for the balance of the year. It can be done in an orderly way, without disrupting the national economy. Lacking the President's doing that, it's just going to be hell.
- Bell: This has got to go up in the first deficiency bill and get through by the end of January.
- H.M.Jr ; Well, if you gentlemen would be willing to drop the stuff and - I don't know how you're fixed for the rest of the day, but I'm available at 4:30; I'm tied up until then. And see what you can do.
- How you fixed, John?
- Hanes: I've got a meeting with Guy and his staff at four o'clock. Tied up until four.
- H.M.Jr: Until four?
- Hanes: Yes, and then I've got a meeting with him and his staff; probably take three quarters of an hour.
- H.M.Jr: I think this is important enough to postpone it. I'd like you to sit in on it.



-55-

Hanes: All right.

H.M.Jr: I think this is our first real challenge; I think we ought to try to meet it. I mean I'd like to go to bed tonight feeling, "Well, I've taken another step in trying to stop this thing from happening." And I think that this is important enough that ....

Well now, how will we do this thing?

Bell: Mr. Secretary, if I may make a suggestion, I might do some work on the figures between now and, say, 3:30, getting as accurate figures as we can together showing just how much money they will need for the next three or four months and the number of people that we'll take care of; and we could meet in my office at - say, at 3 or 3:30 and we could discuss it for an hour.

White: We could in the interim draft a letter, Mr. Secretary, if you want to appoint a small committee to meet with me.

Bell: An hour and a half before your 4:30.

H.M.Jr: Excuse me.

(On phone) Hello. - When? - At 8 o'clock this evening. - Atlanta at 8 o'clock, tonight. - Well then, find out from the White House when does the pouch go down, will you? And also find - there used to be a train that left here for Atlanta at 7; also the planes - when are there planes, see? - Yes, when are there passenger planes to Atlanta. And send that up on a piece of paper. When does the pouch leave and when are there passenger planes on a 24-hour basis to Atlanta? - Please.

Well, you (Bell) say you'll be ready by 3:30.

Bell: I think I will. I might be ready by 3 if I rush a little.

H.M.Jr: Why not say 3 and meet in your office at 3? Which one of your many offices?

-56-

Bell: Budget - better room.

H.M.Jr: 3 o'clock; then you start at 3 to draft the letter.

White: Does it have to be ready at 4:30?

H.M.Jr: I think so.

White: Well, if the letter has to be ready at 4:30, I think some of us could work on the general body of the letter.

Bell: I couldn't work on a letter between that time ...

H.M.Jr: Are you available, Marriner?

Eccles: Yes; I'll want ....

H.M.Jr: Do you want to take some of these boys to your office and work on a letter?

Eccles: I'll be glad to do it.

H.M.Jr: Or how do you want it?

Eccles: Somebody suggested some charts here. Seems to me that might be ...

Taylor: This bubble chart that you've been using is very important in that. You don't have to use the bubbles, but you can do it as applied to only certain expenditures, showing that.

H.M.Jr: Excuse me - couldn't you just walk across the street to Hanes' office and then decide how you'll divide this up? Is that all right?

Eccles: Then we meet here at 4:30.

H.M.Jr: Yes. May I say again, except for the people in the room, I don't want anybody on anybody's staff to know about it, see? But if you want to draw Herbert Gaston in, it will be all right.

RAILROAD EQUIPMENT - A POSSIBLE BOTTLENECK

Under the topic "Bottlenecks" a study has been initiated of the ability of the railroads to handle the peak loads of prosperous years. As a result of the preliminary survey, certain tentative conclusions emerge, which, if borne out by more intensive study, appear to be highly significant. Although attention has been mostly directed toward freight cars, it is believed that the findings apply to other types of equipment.

1. It is estimated that to handle the volume of peak traffic consequent upon full recovery within, say, three years, total car requirements would have to approximate 2,000,000 cars. In contrast with this, the total number of cars on hand at the present time is some 1,700,000, indicating a shortage of 300,000 cars. Adding retirements, the total requirements for new cars would amount to about 600,000 units in three years, or approximately 200,000 per year.

2. If we assume a sufficient degree of recovery by 1940 to represent about the same degree of utilization of our plant capacity in general as prevailed throughout the twenties, which would correspond with a Federal Reserve Board index of production of between 125 and 130, total car requirements would amount to 1,900,000. Taking retirements at about 100,000 per year, this would call for total new car construction of 400,000 in two years.

3. To the extent to which new cars produced in 1939 fall short of 200,000, requirements in 1940, to handle the assumed volume of peak traffic, would have to be correspondingly higher than 200,000.

4. The maximum number of new cars produced in any one year was 150,000 in 1923. This suggests that the capacity in the car making field may be inadequate to handle the volume of possible new requirements. Further study is necessary to verify this indication.

5. The same general conclusions apply to other types of equipment. Thus, under the first assumption of full recovery in three years, annual new locomotive requirements would amount to 3,400 locomotives.

6. Construction activity in new equipment of this magnitude would require a total annual outlay of approximately \$800,000,000.

7. In view of the financial condition of the railroads, and the tendency for orders to be postponed until absolutely necessary, it appears unlikely that expenditures for new equipment of such magnitude will be undertaken in the near future.

8. Assuming, therefore, the continuance of recovery at a desirable rate, there appears to be a very distinct possibility of a shortage of equipment in 1940, of a bottleneck in equipment making capacity, and of a comparatively sudden and relatively large demand for steel from the railroads superimposed on what are likely to be heavy demands from other industries.

November 21, 1958. 2160

**A PRELIMINARY SURVEY OF EXISTING EXPENDITURE PROGRAMS WHICH ARE BEING FINANCED WITHOUT USE OF DIRECT PUBLIC DEBT, OR WHICH MIGHT BE SO FINANCED.**

*See 11/19/58  
p. 238  
"This is..."  
L. Lewis*

Findings

I - Over \$1 billion of guaranteed debt might be substituted at any time for public debt, if suitable administrative and legislative action were taken.

(a) the R. F. C. has \$400 million of borrowings from the Treasury which it could retire by issuing its own debentures. This requires no legislation.

(b) If new legislation were enacted, another one-half billion dollars of direct public debt might be retired by issuing guaranteed bonds against existing assets. The R. F. C. might retire part of its capital stock and the HOLC might take over shares of savings and loan associations owned by the Treasury. Assets of the emergency crop loan program, assets of the rural rehabilitation program and assets that have been transferred to the U. S. Maritime Commission might form the security for issues of newly authorized bonds or notes of Federal agencies. Any such immediate reduction of the public debt would be at the expense of a corresponding reduction in later years.

II - Expenditure programs now in existence or contemplated to the amount of some half billion dollars a year might be financed without the use of direct public debt, providing suitable administrative and legislative action were taken.

This conclusion rests on the following considerations:

-2-

(a) A number of Federal corporate agencies, whose capital stock is owned in whole or in part by the Treasury, will automatically continue to make loans largely without further use of the direct public debt. Among these are the United States Housing Authority, the Commodity Credit Corporation, the Federal Home Loan Banks and the banks and corporations of the Farm Credit Administration. The one of these which will clearly be expanding its assets steadily is the United States Housing Authority; its loans, to be financed with guaranteed bonds, may reach a total of \$150,000,000 by next June and may increase by another \$300,000,000 in the following fiscal year.

(b) If the R. F. C. undertakes to finance all its further loans by issuing guaranteed notes, a loan expansion which might amount to anything from \$50,000,000 to \$250,000,000 could be financed without instead of with the use of direct public debt. This would include loans to municipalities in connection with the P. W. A. program, loans to railroads, loans to public utilities, and loans through the R. F. C.'s subsidiaries, the Export-Import Bank, the R. F. C. Mortgage Company and the Federal National Mortgage Association.

(c) If suitable legislation were enacted, certain other expenditure programs already in existence, which may run from \$100,000,000 to \$200,000,000 a year, might be financed without instead of with the use of direct public debt. The most promising of these programs for this purpose include Rural Electrification loans (now financed partly through the R. F. C.), F. C. A. emergency crop loans, Bankhead-Jones farm tenant loans, Farm Security Administration rural rehabilitation

-3-

leans and U. S. Maritime Commission ship construction.

III - The possibilities of shifting any substantial part of current budgetary expenditures to self-financing agencies appear limited. However, an extension of certain activities of the Government through self-financing corporations would lessen the necessity for other large and continuing budgetary expenditures such as work relief and public works. Thus a shift of certain existing programs to a self-financing basis plus an extension of Government activities that could be so financed would permit, either directly or indirectly, a budgetary balance to be attained more quickly, yet with no more danger, than is now possible.

THE HAY-ADAMS HOUSE  
WASHINGTON, D. C.



Next Meeting

Reports of Progress.

1. National Income + Budget  
Treasury.
2. Potential Income
3. Bottle Necks
4. Effect of Budget Items
5. Effect of operations outside  
the Budget
6. Flexibility - Income  
Expenditures
7. Timing



MEETING OF FISCAL AND MONETARY ADVISORY  
BOARD (re possible WPA lay-offs)

November 21, 1938.  
4:50 p.m.

Present: Mr. Eccles  
Mr. Ruml  
Mr. Bell  
Mr. Hopkins  
Mr. Hanes  
Mr. Taylor  
Mr. White  
Mr. Currie  
Mr. Oliphant

H.M.Jr: I had a minute to explain to Mr. Hopkins that in the meeting of our Fiscal and Monetary Committee this morning I brought to you gentlemen's attention in utmost confidence the fact that on Friday the President said that he would not sign... - is Dan here? Where's Dan?

White: He just stepped out.

H.M.Jr: Well, he knows what I'm saying.

(Bell comes back)

I was saying that I told these people in the utmost confidence that as of Friday the President said he would not sign a document declaring a national emergency and making this 175 million dollars available, as a result of which this new-born committee felt that if we were going to do anything and had the possibilities of a million men being laid off the next week or two, there wasn't much use discussing anything either fiscal or monetary. So I asked them if they wouldn't draw up a document that we could send down to the President, which all of us can sign, recommending that he should sign this. And inasmuch as you're (Hopkins) the patient, I felt that before we performed an operation on you, at least we'd show you the diagnosis.

I haven't seen this yet; I'll read it out loud. Is that right?

"My dear Mr. President:

"The Acting Director of the Budget..." - and before I start, is everybody here in agreement on this? Anybody?

-2-

- Eccles: Well, we're in as full agreement as we could be on a tentative basis. It was decided that we wouldn't want to put our signature to it at the moment and send it down tonight. It's too important. It's a matter that might have to be deferred. Herman can explain some reasons for that as well.
- H.M.Jr: All right. "The Acting Director of the Budget at the meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of W.P.A. expenditures scheduled for the next three months."
- Now, why do you do it that way? He didn't do it; I did it.
- Bell: Well, I suppose they have a reason for that.
- Taylor: He's supposed to have done it.
- H.M.Jr: It's not factual; it's not factual. Is this the way you (Bell) want it?
- Bell: I didn't know why they did it. I was working on something else. But I assumed they had a very good reason for doing it: that it's my responsibility under the Act to apportion the funds and it was my duty to bring the situation to the attention of the President and next, I suppose, to you. I'd just as soon turn it around the other way.
- H.M.Jr: Well, I always think that the best way to do it is to do it the way it happened.
- Bell: O.K. by me.
- H.M.Jr: I never like to dress up my scenery.
- Bell: It's all right by me. I thought they had a particular reason for doing it.
- H.M.Jr: I always think it's much better to tell the thing the way it happened.
- Bell: It can very properly come from the Chairman of this Committee.
- Ruml: Chairman of the Board.

-3-

Eccles: There was no discussion on that, I don't think. Don't think it makes any difference. Merely a question of the reason for the consideration.

H.M.Jr: Then we'll say "The Secretary of the Treasury." That's the way it happened.

"The Secretary of the Treasury at a meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of W.P.A. expenditures scheduled for the next three months.

"The Board, on the basis of the information presented to it and of study of work relief requirements for the next three months in relation to the general business situation, recommends that if possible you make available the \$175 million of additional funds for work relief purposes by the authority vested in you in accordance with the provisions of the Emergency Relief Appropriation Act of 1938."

Now if I was saying this I'd recommend - I'd leave out "if possible." Either we're going to do it or we aren't.

Eccles: Well, there's a question ...

Taylor: Legal reason.

H.M.Jr: Well then, why write the letter? Why write the letter?

Bell: Mr. Secretary, the question raised in the meeting was as to whether this Committee as such should pass on a legal matter that's going to the President.

H.M.Jr: I wouldn't send it unless it's all right. I never wrote a letter to the President recommending "if possible, you should do so and so." Either recommend it or not recommend it.

Eccles: We'd be assuming the question of passing upon whether or not it's possible. Now, we don't - we're speaking of it from an economic point of view. Now, if from an economic point of view it ought to be done if it can be done, as to whether it can be done from the legal point of view we don't

-4-

know.

H.M.Jr: Well, if you don't mind, I know my President and I'm not going to put my name to this thing unless I can say, "I recommend that you make available." I'm not going to say, "I recommend that if possible you make available." I mean immediately I put a doubt in his mind. I mean if there is some doubt - now, I had three minutes with Harry Hopkins and I said, "There is some legal doubt, Hanes tells me." He said, "Well, our shop has no legal doubts."

I mean I'd rather hold the thing until there is no doubt.

Oliphant: Well, all the discussion - none of the discussion was in terms of the legal doubt. I think Ruml pointed out that since this is the first action on the part of the Committee, the Committee wanted to be very careful as a committee of not stepping outside of its bailiwick.

Ruml: Mr. Secretary, it seemed to me that the President had access to counsel as to the legality of this thing; the Fiscal and Monetary Advisory Board can only speak on the monetary aspects of the thing. On those we are clear, but we can't presume to search out counsel to advise him on the legality of the matter.

H.M.Jr: I still get back - if I'm going to sign that thing, I'm going to say "recommend you make available" and not "recommend, if possible, you make available." I won't sign it.

Taylor: Don't think that would be impossible.

White: The assumption is the Secretary of the Treasury should have obtained such counsel as is necessary in order for him to make sure it is possible; that if it wasn't possible he should have ascertained that ahead of time.

Ruml: I assumed there will be some statement that goes to him from another source that will refer to the law and what can be done; but I - and I ....

-5-

- H.M.Jr: Well, the normal thing, the way that's done - and Hopkins and Bell can check me on this thing, see, I'm doing my home work right before you - is that that statement, I think, would go from the Director of the Budget, wouldn't it? Wouldn't you send him a statement declaring a national emergency? Doesn't that go from you, then - first from you to Mr. Hull for his stamp? Doesn't it go down in that way?
- Bell: If it's in the form of an Executive Order, yes. But we've been discussing another form here and it might be a letter from the President to me, which certainly could be drawn in the Bureau of the Budget, with the help of proper counsel.
- H.M.Jr: Let me just check with Hopkins. If Hopkins tells me we've got another 24 hours on it, I'd stop right here and give these boys another 24 hours, because I'm not going to send one of these "Maybe you can and maybe you can't" letters. It's too important; I want to make a positive statement or keep my mouth shut. Can you (Hopkins) wait another 24 hours?
- Hopkins: I have no intention of firing that many people.
- H.M.Jr: What?
- Hopkins: I have no intention of firing a million people off the WPA pay-roll. I'm going down to talk to the President about it, talk it over with him. I'm sure he's - any judgment he's made has been made on some very bad advice and on inconsiderate evidence, and I want to discuss it with him.
- H.M.Jr: You're not going down tonight?
- Hopkins: I'm not going down until he gets rested, gets a lot of sleep, and is feeling good.
- H.M.Jr: Then by holding this another 24 hours ....
- Hopkins: Isn't anybody going to go off that pay-roll by holding it another 24 hours.
- H.M.Jr: Then I'm going to say this: "... recommends that you make available the \$175 million of additional funds for work relief purposes by the authority vested in you in accordance with the provisions of the

-6-

## Emergency Relief Appropriation Act of 1938.

"When in the Spring of 1938 you recommended to Congress the comprehensive recovery legislation of which the appropriation for work relief formed an important part, the possibility was envisaged by Congress that a situation might arise which would call for expenditures beyond those anticipated at this time.

"Although there has been a marked increase in industrial production ...."

Bell: ".... at that time."

H.M.Jr: "Although there has been a marked increase in industrial production ..."

Bell: "... would call for expenditures beyond those anticipated at that time."

H.M.Jr: "...anticipated at this time," it says.

White: "... at that time."

H.M.Jr: "Although there has been a marked increase in industrial production, and, we believe, a sound foundation for the continuance of recovery has been established, nevertheless the level of unemployment remains higher than was anticipated. It has naturally been extremely difficult to accurately determine when work on the heavier type of projects represented by the public works and public housing programs could become fully effective."

Now, don't protest too loudly at this time, Harry, that at this point ....

Hopkins: I don't protest. I hope you send it.

H.M.Jr: I thought you might not like that sentence.

"Likewise, the New England hurricane not only has dislocated industrial production over a wide area with its attendant effects on normal employment, but also has imposed additional burdens on the Works Progress Administration. In addition, private re-employment was further retarded by the depressing

-7-

effects on American trade and industry of the extremely critical international political situation. Finally, there has been an unforeseen degree of lag in relief requirements behind the turn of industrial production."

"Finally, there has been an unforeseen degree of lag in relief requirements behind the turn of industrial production." What does that sentence mean? "Finally, there has been an unforeseen degree of lag in relief requirements ...."

White: In other words, the upturn in employment was not nearly as large as one would expect.

H.M.Jr: Well, that doesn't say that, Harry.

Currie: I think part of his thought was that normally the experience of WPA has been that there is a lag in requirements behind business activity; but this time there's an unforeseen larger degree of lag.

H.M.Jr: This says the opposite.

Oliphant: That it goes up with recovery in private re-employment.

H.M.Jr: Say, "There has been an unforeseen lag in private employment," not "in relief requirements." Do you mind?

Currie: Well, the turn in relief requirements usually comes after you've turned upward in production.

H.M.Jr: Do you mind my using - as the President says, the man on the street doesn't understand that. You economists may, but I don't. What you're saying is that private employment hasn't kept pace with business recovery. Isn't that what you want to say for me?

Taylor: He wanted to say something else.

Currie: We're trying, Mr. Secretary, to say something more than that.

H.M.Jr: Well, it has to be clarified. I don't think this says what you have in mind.

-8-

Currie: We can clarify it.

H.M.Jr: "A combination of these circumstances has thrown a preponderant share of the recovery burden on the W.P.A. portion of the program during the last five months."

That's all right.

"Since it was necessary to meet these unforeseen demands it would be necessary to cut the W.P.A. rolls by almost one million if we are to remain within the appropriation made by Congress for the first seven months of the fiscal year."

"Since it was necessary to meet these unforeseen demands it would be necessary to cut the W.P.A. rolls by almost one million if we are to remain within the appropriation made by Congress for the first seven months of the fiscal year."

"Since it was necessary to meet..." - it would be necessary to cut them now. Want to leave out the time?

Taylor: I think if you insert to read like this: "Since it was necessary to meet these unforeseen demands we understand that it would now be necessary..."

H.M.Jr: Yes. Say that again, Wayne.

Taylor: "Since it was necessary to meet these unforeseen demands, we understand that ...."

H.M.Jr: "... we understand that ..."

Taylor: "... that it would now be necessary..."

H.M.Jr: "... it would now be necessary..."

Taylor: "... now be necessary..."

H.M.Jr: "... now be necessary to cut the W.P.A. rolls by almost one million if we are to remain within the appropriation made by Congress for the first seven months of the fiscal year."

Is that all right with you (Eccles)? We'll all have time, Marriner, to do this again tomorrow.



-9-

- Eccles: That's all right. This has no critical - in fact, we haven't been over it since it was finally written.
- H.M.Jr: If you don't - I mean I want you to have all the time you want; I want an equal amount. But we couldn't take it in its present form.
- Bell: Is that figure about right, Harry?
- Hopkins: What figure do you mean?
- Bell: A million people, if you're going to live within the appropriation.
- Hopkins: (Nods yes)
- Bell: That's about right?
- Hopkins: Close enough. The language isn't accurate in several other spots there, but it isn't important; we're going to live within the appropriation.
- H.M.Jr: How?
- Hopkins: Why not?
- Oliphant: He means if pursuant to the appropriation you declare the emergency.
- Hopkins: In the letter you assume we aren't living within the appropriation. We are completely living within the appropriation, under my proposal. That's a matter that isn't important, though.
- Oliphant: Should you say "such a drastic.."?
- H.M.Jr: What?
- Oliphant: "... such a drastic"? Could cut out the ....
- Taylor: Don't need the word "such." Just "drastic curtailment."
- H.M.Jr: "... would be extremely unwise from the standpoint of continued recovery."
- "It is our opinion that a drastic curtailment of the relief rolls at this time would be extremely unwise from the standpoint of continued recovery."

-10-

"It is essential that an increase in consumption be maintained if recovery is to continue. A drastic reduction in work relief expenditures will tend to depress consumption."

Well, I think you're getting into - both those paragraphs, I think, could be left out. I think you're arguing too much now, but - I mean I - like my father always said, when you've won your case, quit.

"In view of the foregoing.... " - I question those two paragraphs. I question those two paragraphs. I think that's throwing in a little extra.

"In view of the foregoing the Fiscal and Monetary Advisory Board feels that, from the standpoint of a proper timing of government expenditures with the requirements of the general economic situation, it would be exceedingly unwise to cut work relief expenditures drastically at this time."

Well now, gentlemen, as far as I'm concerned, I'd be willing to sign that as it is written, with a few modifications anybody wanted to make. Let me just - but we wouldn't be ready tonight. You won't be ready tonight.

Hopkins: It doesn't need to go tonight.

H.M.Jr: Let me cut - I've got a whole chain arranged for McKay to go down ....

(On phone) Lieutenant McKay, please.

(McKay comes in)

H.M.Jr: Mac, you're not going down tonight.

McKay: Thank you.

H.M.Jr: Will you undo everything - Bob McHugh, Assistant Chief Murphy - undo everything, will you? Have a good sleep.

-11-

McKay: All right, sir. Thank you. (Leaves)

H.M.Jr: Well now, gentlemen, it's 5:20, and why don't we tackle this thing again tomorrow? And then when we got the thing a little bit more polished, maybe Mr. Hopkins would come over again.

Hopkins: Glad to.

H.M.Jr: Why not? Hopkins is going to lunch with me tomorrow at one o'clock. Then why don't we meet at 2 o'clock or, say, 2:15, and maybe we can go into this thing then.

Eccles: Not meet again in the morning, then.

H.M.Jr: Unless you and your people want to meet.

Eccles: What's your situation, Beardsley?

Ruml: I'm going back to New York for dinner tonight. I could come back on the over-night train, if you think it's important, but it would seem to me that with the thing in this form it's a question of getting the correct phraseology and being sure Mr. Oliphant is satisfied.

H.M.Jr: I think you've been extremely helpful today, and when we get this thing fixed up the boys can read it to you over the telephone. I don't like to ride a willing horse to death. No, I don't think it's - I mean ....

Ruml: I'll be glad to come if you think it's necessary.

H.M.Jr: No, I think not. You've got time, if you've got your bag. Have you?

Ruml: Everything is ready.

H.M.Jr: The thing, as it is here now, which is, as far as you're (Hopkins) concerned, would you say ....

Hopkins: Fine.

H.M.Jr: ... 95 percent ...

-12-

Hopkins: You're a big help to me.

H.M.Jr: What?

Hopkins: Fine.

H.M.Jr: Well, there you are. Now, Hopkins, could you turn over to Oliphant whoever has told you that it's legally possible?

Hopkins: Surely.

H.M.Jr: What?

Hopkins: Surely. Could he get in touch with Herman at 9 tomorrow morning?

Hanes: Shouldn't we correct those few errors that Harry Hopkins ....

Hopkins: Somebody ought to work on it.

Hanes: ... things in there that are not correct?

H.M.Jr: I don't want it rewritten.

Hopkins: Suits me. I'm not worried about that.

H.M.Jr: I question the paragraph "It is our opinion that such a drastic curtailment of the relief rolls at this time would be extremely unwise from the standpoint of continued recovery." And "It is essential that an increase in consumption ...." - those two paragraphs are repetitious.

Taylor: You can cut them out, because you say that practically in the last paragraph.

H.M.Jr: Well now, Dan, could you at 2:15 - could you all come in here with an airtight thing that you feel - if it's possible to have an airtight thing - that we can send down to the President in final form? We'll argue about it at 2:15. But in the first place, I think it's up to us in the room here to give him something which will stand up legally, so it really is between you and Oliphant and somebody to represent Hopkins. He says he's got somebody he can throw in?

-13-

- Eccles: Well, does Harry ....
- Hopkins: Tomorrow morning.
- H.M. Jr: What?
- Hopkins: Tomorrow morning.
- Eccles: I'd like to ask Harry a question. Does he figure that this 175 million is available now without further action?
- Hopkins: Requires some action of the President.
- Eccles: Yes.
- Hopkins: Oh yes.
- Eccles: Your program is on the assumption that he will make that available.
- Hopkins: That's right, and that if he made that available, our dollar expenditures per month for December, January, and February would drop something over seven million or eight million dollars, so in the month of February you'd spend 23 or 24 million dollars less than we spend in the month, say, of November.
- Eccles: Yes, but I think Dan ....
- Bell: That's right.
- Eccles: ... estimated that - that's assuming this is made available.
- Hopkins: The reason this is important for this committee to consider - Congress has already made available three billion dollars, and they're going to have to make available an emergency deficit for us of X amount. Up to the first of November, with the cash going out of the Treasury of those two amounts, for Public Works and for ourselves, 780 million dollars in check were drawn out of the Treasury for the WPA and 5 million dollars in checks were drawn out of the Treasury for PWA.
- Bell: That's right.

Hopkins: Now, if that has a monetary effect you can readily see that one of the things this committee ought to know is how fast the dollars are going out of the Treasury on the heavy stuff. You know that no matter what you do, our plan is to drop - no matter, under any circumstances, we drop in WPA a minimum of 7 million dollars a month, each month; so in three months that would be 21 million dollars plus, under any circumstances.

Now, if your committee, then, were to go one step further, instead of generalizing about this, and say that if you didn't have to consider the problem of unemployment relief, you weren't considering that problem, but that here is the curve that you'd like to see go, approximately, of dollars each month, out of the Treasury; then talk to us as to whether it would be possible, between Ickes and myself and others that have Government funds that they can control to some extent - incidentally, mine are about the only funds that are now controllable, because the rest of it is now tied up in contracts - as to whether we could adjust our problem so that it would substantially fit the theoretical curve that you people would lay out.

Now, I don't know whether that's worth working out or not, but we'd be glad to, if you thought that was an interesting thing to help work with, to see to what extent we could adapt our program to what you think would be a theoretically desirable thing in terms of dollars going out of the Treasury, projected, let's say, eight months ahead, a year ahead.

H.M.Jr: But not in this letter.

Hopkins: No, I'm thinking of something else.

Secles: I think the thing Harry is talking about is absolutely essential, but not in this thing.

Hopkins: No, but as a long-range planning.

Taylor: That's what your committee is supposed to be doing.

H.M.Jr: That's what they're supposed to be doing.

Secles: That's the heart of the job.

-15-

- Hopkins: Of course, the realities of the thing - I mean as far as the next eight months is concerned, the only outfit in the Government that's got any control over real dollars - the rest of them, you can make them for a few millions, but not any real money; isn't that right, Dan?
- Bell: That's right.
- Hopkins: I'm perfectly frank in telling you now that we're - just in theory, now, without ever having submitted it to the Budget or ever having its approval, the thing looks like a drop of a minimum of 7, and it might run up as high as 10 million a month drop right up to the end of the fiscal year.
- Bell: Is that a normal turnover, Harry?
- Hopkins: No, that's being pretty tough with it. That's being pretty tough with it.
- Bell: You're not actually letting anybody go, but those are the people that are leaving voluntarily.
- Hopkins: We don't make any replacements right now.
- Bell: That's what I mean.
- Hopkins: That catches about a hundred thousand people a month.
- Oliphant: How much in dollars?
- Hopkins: That's about 7 million dollars a month.
- Eccles: That's cumulative, isn't it? I mean 7 million a month ....
- Hopkins: That's right. Three months is 21 million a month.
- White: Doesn't make any provision for the seasonal unemployment.
- Hopkins: Well, the curve would be in our favor next spring; we'd get a sharper drop in the spring than in winter-time. But I think in the winter-time, if we don't take anybody in, which is going to be a tough thing

-16-

for us to hold, we'll get at least a hundred thousand a month off the WPA during the winter months.

- Bell: Runs about five percent a month when you're on such a high level.
- Hopkins: Well, if we get five percent a month, we'll get more than that.
- Eccles: You said from now until - the balance of the fiscal year - next July, Harry, that your expenditure would continue to drop at this rate.
- Hopkins: Oh, under the thing - the curves we've got in our office - now, this is irrespective of what money we got or what Congress or the President will do - we'd be spending in the month of June next year about 125 or 130 million dollars a month, which is in round figures 50 to 60 million a month less than we are spending now. Our figures don't always run uniform each month.
- Bell: That's about two million people.
- H.M.Jr: Yes.
- Hopkins: It will be right there about the first of July.
- Eccles: That will depend on what - if Congress should give you more money, if the situation was such you needed more. You're just assuming, however, that they don't give you more; then you're estimating ....
- Hopkins: What you've got to do, your committee has got to do - Ickes got a billion and a half, I got a billion and a half plus whatever I'm going to get until July first, and that total is so much money and that's what the two of us spend. Now, what you going to spend next, what should you spend ....
- H.M.Jr: Harry, I admit I'm all in. I'd like to take this up tomorrow afternoon. I'm going to pin this on you, Johnny Hanes. You're (Hopkins) lunching with me at one o'clock. Then 2:15. And Johnny Hanes is carrying the ball for me tomorrow morning. Huh?
- Oliphant: Will you tell your folks, Harry, to call me?



-17-

Hopkins: I'll call before I leave.

H.M.Jr: Harry, everybody in this room is pledged to secrecy.

Hopkins: Yes, I think it's important that there be no implication that a million people are going to be dropped from WPA.

My dear Mr. President:

*Secretary of the Treasury*  
 The ~~Acting Director of the Budget~~ at the meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of W.P.A. expenditures scheduled for the next three months.

The Board, on the basis of the information presented to it and of study of work relief requirements for the next three months in relation to the general business situation, recommends that ~~if possible~~ you make available the \$175 million of additional funds for work relief purposes by the authority vested in you in accordance with the provisions of the Emergency Relief Appropriation Act of 1938.

When in the Spring of 1938 you recommended to Congress the comprehensive recovery legislation of which the appropriation for work relief formed an important part, the possibility was envisaged by Congress that a situation might arise which would call for expenditures beyond those anticipated at ~~that~~ <sup>that</sup> time.

Although there has been a marked increase in industrial production, and, we believe, a sound foundation for the continuance of recovery has been established, nevertheless the level of unemployment remains higher than was anticipated. It has naturally been extremely difficult to accurately determine when work on the heavier type of projects represented by the public works and public housing programs could become fully effective. Likewise, the New England hurricane not only has dislocated industrial production over a wide area with its attendant effects on normal employment, but also has

- 2 -

imposed additional burdens on the Works Progress Administration. In addition, private re-employment was further retarded by the depressing effects on American trade and industry of the extremely critical international political situation. Finally, there has been an unforeseen degree of lag in relief requirements behind the turn of industrial production. A combination of these circumstances has thrown a preponderant share of the recovery burden on the W.P.A. portion of the program during the last five months.

Since it was necessary to meet these unforeseen demands it would be necessary to cut the W.P.A. rolls by almost one million if we are to remain within the appropriation made by Congress for the first seven months of the fiscal year.

It is our opinion that such a drastic curtailment of the relief rolls at this time would be extremely unwise from the standpoint of continued recovery.

It is essential that an increase in consumption be maintained if recovery is to continue. A drastic reduction in work relief expenditures will tend to depress consumption.

In view of the foregoing the Fiscal and Monetary Advisory Board feels that, from the standpoint of a proper timing of government expenditures with the requirements of the general economic situation, it would be exceedingly unwise to cut work relief expenditures drastically at this time.

My dear Mr. President:

The Secretary of the Treasury at the meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of W. P. A. expenditures scheduled for the next three months.

He pointed out that in the spring of 1938 when you recommended to Congress comprehensive recovery legislation of which the appropriation for work relief formed an important part, the possibility was envisaged by Congress that a situation might arise which would call for expenditures beyond those anticipated at that time, and therefore provided for an additional \$175 million to be utilized if necessary.

Although there has been a marked increase in industrial production, and, we believe, a sound foundation for the continuance of recovery has been established, nevertheless the level of unemployment remains higher than was anticipated. It was naturally very difficult to predetermine accurately when expenditures on the heavier type of projects represented by the public works and public housing programs would become fully effective. We find that from July 1st to November 15th, 1938, the total withdrawal from the Treasury by <sup>P.W.A.</sup> W. P. A. was only \$34 million. In this same period withdrawal by U. S. Housing Authority was less than \$4 million.

In addition to the foregoing, the New England hurricane dislocated industrial production over a wide area and also imposed additional burdens on the Works Progress Administration. Private re-employment

has been and is being further retarded by the depressing effects on American trade and industry of the extremely critical international political situation. Finally, there has been an unusual lag in private employment despite the sharp increase in industrial production. A combination of these circumstances has thrown a preponderant share of the recovery burden on the W. P. A. portion of the recovery program during the last five months. The total expenditure by this agency during the period amounted to approximately \$562 million.

It would now be necessary to cut the W. P. A. rolls by almost one million workers if we are to remain within the appropriation made by Congress for the first seven months of the fiscal year. Therefore, the Fiscal and Monetary Advisory Board recommends that you make available the \$175 million of additional funds for work relief purposes by the authority vested in you in accordance with the provisions of the Emergency Relief Appropriation Act of 1938.

Faithfully,

P. S. Appended are two charts showing the lag in private employment despite sharp increase in industrial production.

Chart 1 - Industrial Production and Total Non-Agricultural Employment.

Chart 2 - Total Labor Supply - Not Classified by Regular Employment, Emergency Employment and Unemployment.

My dear Mr. President:

The Secretary of the Treasury at the meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of the Works Progress Administration expenditures scheduled for the next three months.

He pointed out that in the spring of 1938 when you recommended to Congress comprehensive recovery legislation of which the appropriation for work relief formed an important part, the possibility was envisaged by Congress that a situation might arise which would call for expenditures beyond those anticipated at that time.

Although there has been a marked increase in industrial production, and, we believe, a sound foundation for the continuance of recovery has been established, nevertheless the level of unemployment remains higher than was anticipated. It was naturally very difficult to predetermine accurately when expenditures on the heavier type of projects represented by the public works and public housing programs would become fully effective. We find that from July 1st to November 16, 1938, the total withdrawal from the Treasury by the U. S. Housing Authority was less than \$4 million and by the Public Works Administration less than \$34 million. Moreover, the total withdrawal by the W. P. A. for the same period amounted to approximately \$882 million.

In addition to the foregoing, the New England hurricanes dislocated industrial production over a wide area and also imposed additional burdens on the Works Progress Administration. Private re-employment has been and is being further retarded by the depressing effects on American trade and industry of the extremely critical international

- 2 -

political situation. Finally, there has been an unanticipated lag in private employment despite the sharp increase in industrial production. A combination of these circumstances has thrown most of the recovery burden on the W. P. A. portion of the recovery program during the last five months.

It would now be necessary to cut the W. P. A. rolls by almost one million workers if we are to remain within the apportionments of funds by months hitherto made pursuant to the Emergency Relief Appropriation Act of 1938. ~~Moreover, if present reserves are not released, and future~~  
~~L. P. A. program funds are not released.~~ Therefore, the Fiscal and Monetary Advisory Board respectfully recommends that you both release all present reserves and also modify the apportionments by months hitherto made by reducing the period of apportionment from eight to seven months.

Faithfully,

P. S. Appended are two charts showing the lag in private employment despite sharp increase in industrial production.

Chart 1 - Industrial Production and Total Non-Agricultural Employment.

Chart 2 - Total Labor Supply - WPA Classified by Regular Employment, Emergency Employment and Unemployment.

My dear Mr. President:

The Secretary of the Treasury at the meeting of the Fiscal and Monetary Advisory Board on November 21, 1938, presented material to the Board which related to the program of W. F. A. expenditures scheduled for the next three months.

He pointed out that in the Spring of 1938 when you recommended to Congress comprehensive recovery legislation of which the appropriation for work relief formed an important part, the possibility was envisaged by Congress that a situation might arise which would call for expenditures beyond those anticipated at that time.

Although there has been a marked increase in industrial production, and, we believe, a sound foundation for the continuance of recovery has been established, nevertheless the level of unemployment remains higher than was anticipated. It was naturally very difficult to predetermine accurately when expenditures on the heavier type of projects represented by the public works and public housing programs would become fully effective. We find that from July 1st to November 18, 1938, the total withdrawal from the Treasury by the U. S. Housing Authority was less than \$4 million and by the Public Works Administration under the program authorized by the Emergency Relief Appropriation Act of 1938, exclusive of Federal projects, about 80 million dollars, of which only 34 million was withdrawn under the 1938 Relief Act. Whereas, the total withdrawal by the Works Progress Administration amounted to approximately \$822 million.

In addition to the foregoing, the New England hurricane dislocated industrial production over a wide area and also imposed additional burdens on the Works Progress Administration. Private re-employment has been and is being further retarded by the depressing effects on American trade and industry of the extremely critical international



## GROUP MEETING

November 21, 1938.  
9:30 A. M.

Present: Mr. Oliphant  
Mr. Gaston  
Mr. Haas  
Mr. Hanes  
Mr. Taylor  
Mr. Duffield  
Mr. Lochhead  
Mr. White  
Mr. Gibbons  
Mr. McReynolds  
Mrs. Klotz

H.M.Jr: Mac?

McReynolds: (Nods "Nothing.")

H.M.Jr: I haven't had time to get down to earth.

McReynolds: Nothing.

H.M.Jr: Good morning. How's sterling?

Lochhead: Well, it's shaded off a little bit since the time you spoke last; it is now about 4.69 $\frac{1}{2}$  - 4.70; apparently not much excitement in the market, but a little pressure. Had no further cables since the earlier one.

H.M.Jr: Well, I'll try to do my home work on sterling today; I'll get an hour and I'll read that stuff. We'll see how it goes along.

Lochhead: Knoke is back; I had him in my office this morning.

H.M.Jr: You're going to turn him over to the White House?

Lochhead: (Nods "Yes.")

H.M.Jr: Work out a very definite schedule for him.

(Nods to Mr. Gibbons.)

- 2 -

Gibbons: Nothing startling in mine.

H.M.Jr: Harry?

White: There was some information from Brazil last week that they have renewed their compensation arrangements with Germany, on a small scale, but they have renewed it.

H.M.Jr: The Brazilian Financial Attache, at my invitation, is coming in at ten thirty tomorrow.

White: We have had a proposal - what might be done for Brazil, if you want to take a look at it.

H.M.Jr: Supposing you boys come in at ten - Taylor, White, and Archie.

White: Oliphant's working on a particular .....

H.M.Jr: I'll just take it in memorandum form, huh?

White: Yes.

H.M.Jr: All right.

Oliphant: You know my slant on the thing, anyway.

H.M.Jr: Yeah. If you want - you want to sit in at ten o'clock?

Oliphant: No, I don't think so.

H.M.Jr: What?

Oliphant: (Nods "No.")

H.M.Jr: (Nods to Mr. Duffield.)

Duffield: (Nods "Nothing.")

H.M.Jr: (Nods to Mr. Hanes.)

Hanes: Could I see you about five minutes? I've got some matters in the Bureau I don't want to bring up here - not important enough. I just want to hand you some papers.

H.M.Jr: Yeah. Well, how about - well .....

- 3 -

Hanes: Any time is all right; there's no hurry about this; any time you want.

H.M.Jr: Two forty-five?

Hanes: O. K.

H.M.Jr: Or have you got an appointment of your own?

Hanes: No, I don't think I've got any. I'll let you know if it isn't all right, but I am sure it is all right.

H.M.Jr: How is the game?

Hanes: Pretty well.

H.M.Jr: Outside or inside?

Hanes: Both.

H.M.Jr: Is that all?

Hanes: Yes.

H.M.Jr: Ah - Wayne?

Taylor: We got a letter from the President on Saturday about this stamped envelope problem, and so on - the same thing arises there that did about illustrating stamps themselves.

H.M.Jr: Why did that go to you?

Taylor: Well, it was just an accident.

H.M.Jr: I'd already turned it over to Oliphant about three days earlier. That fellow Clark was in here, from the stock company.

Taylor: Well, there was a letter that come through for signature with an "Acting Secretary" stamp on it and I signed it.

H.M.Jr: Did you say he could or couldn't?

Taylor: Did a little "weasel" wording on it.

- 4 -

H.M.Jr: Well, let's see what Oliphant did on it.

Taylor: It's being reconsidered, I understand, this morning.

Oliphant: I understood that letter that came over from the President, it went from you to Bernie, and Bernie told me he was working on it and it will be ready today.

Taylor: That is right.

H.M.Jr: That's all right; then we do work together.

Without knowing anything about the law, if you can illustrate - take a stamp and illustrate it, I don't see why you can't take a stamp on an envelope and illustrate it.

Taylor: It seems that way to me.

H.M.Jr: Yeah. What else, Wayne?

Taylor: That's about the only one.

H.M.Jr: If you've got anything on Brazil, you will let me know, won't you?

Oliphant: Would you mind reporting, Wayne, on the status of that letter from the State Department we are waiting on?

Taylor: Hasn't it been received yet?

Oliphant: No. On the German thing.

H.M.Jr: I haven't received any answer.

Oliphant: I haven't either.

Taylor: The last I heard about it was that it was on Secretary Hull's desk.

H.M.Jr: That's the one they told Kieley that he had taken it home with him.

Taylor: I ran into him, Friday night I guess it was, at dinner, and he said, "What more trouble is the Treasury cooking up for me?" and I said I didn't know of any.

- 5 -

H.M.Jr: Who was this, Hull?

Taylor: Yes. That may be what he was talking about, but he wasn't very explicit.

H.M.Jr: Well, that's all right. He jumped <sup>on</sup>/Herbert Feis because he said that there wasn't any - also on Sayre.

Taylor: On the lack of coordination or cooperation between the two Departments. You see that letter that Hull wrote me, which was written about the same time I was talking to Sayre, was written by Feis, and he didn't know that I'd talked to Sayre, and he didn't know that Sayre talked to the British Ambassador, and so, naturally, when Hull gets my letter, sort of putting him on the spot, he naturally was sore, and he wanted to know how come, and so Feis jumps on Sayre. But the letter, you see, that Feis wrote for Hull's signature, was written just at the time I was talking to Sayre, and he didn't know Sayre had sent us the memo, and Feis didn't even know Sayre was talking to the British Ambassador. If it enclosed a copy of Sayre's conversation, which it did, he can .....

H.M.Jr: We got Sayre's thing the day before.

Taylor: Yes, but when Feis writes the letter for Hull's signature, which mentions .....

H.M.Jr: If I was in Hull's shoes, I'd be sore too; I mean getting my letter. I refused to be on the spot, so I put him on the spot, and the reason - he never would have written the letter, I believe, if Sayre and Feis had gotten together. Just passing it along, as you are my contact. This is a State Department matter. I'd be sore too - good and plenty. But we'll wait until that letter - I am not going to call up Mr. Hull any more; we called him three weeks today; we called him three times last week, and I spoke to Sayre last week at lunch. I asked Sayre, where was that letter, and he said it was on Mr. Hull's desk. Called the man three times, and called the Assistant Secretary one; that's about all. I'll wait.

Taylor: I've gone on two or three scouting expeditions too.

H.M.Jr: I can wait; I have too. I can wait.  
George?

Haas: I have a few regular things here.

H.M.Jr: George, are you going to be ready at ten fifteen to give us an example? I don't want to embarrass you by asking.

Haas: Well, that doesn't embarrass me.

H.M.Jr: Well, hell, when are you going to be ready, George?

Haas: When you left that you asked Bell to take the three reports and see what he could find out, and - ah - he has them. Bell has them. Now, as to getting illustrations of Ruml's diagram, I don't know if I ever can do that, and I am very doubtful if anybody else can ever do it, and Ruml doesn't - in my discussions with him, he doesn't feel that you - now that you can actually get an illustration, putting numbers on them, so the .....

H.M.Jr: I thought you said last time that you could do it, using this year's income.

Haas: Not to conform with that table.

H.M.Jr: Yes.

Haas: No.

H.M.Jr: What's the sense of the table? It's very pretty to have examples of.

Haas: It is his way of illustrating a theoretical point. Sometimes, Mr. Secretary, you can know that such a thing exists in a quantitative way, but find it is impossible to get an illustration. Another thing that these numbers show - I am confident, but there is disagreement among economists - on it is that the numbers would change with the different phases of business activities on the outside.

- 7 -

- H.M.Jr: I tell you, not to embarrass either you or Ruml, suppose the two of you stay behind and I'll see you both. It is terribly important; I don't want to put either of you on the spot.
- Haas: It doesn't embarrass me, because I haven't done anything about it, but I don't want to give you something and have you think you've got something, and I feel confident you don't have anything.
- H.M.Jr: Tell the same thing to Ruml.
- Haas: I have. He told me we should refrain from giving you anything with numbers; I told him he didn't have to worry about me, with that standing.
- H.M.Jr: The two of you stay behind today.
- Haas: I had a long talk with Curry. You asked me to go over that, and we are working .....
- H.M.Jr: On my weekly business report?
- Haas: No, no; that material isn't the type of thing you could put in your business report. As a matter of fact, if you take it for what Curry would himself use it for, it is all very good, but those figures Curry wouldn't publish; you see, it is the very roughest figures, making approximations to demonstrate a theory, and he wouldn't publish them over his name, in the status they are in. Maybe, sometime, with further improvement, he would allow them to be published, but he told me, in the present status he did not want to publish them. I think that is one thing when you see charts - whoever is presenting them. There are all kinds of statistics, representing fact, and another group that represents partly fact and partly estimates; another group of statistics, like Ruml had, are merely thoughts, quantities expressed, and to put the three of them in the same category is misleading. I don't think he intended to mislead. They should be talked about; they should explain what they are.
- H.M.Jr: Well - well, anyway .....

- 8 -

Haas: I - I think - I mean, if I am doing it, I won't give you anything unless I feel you can take it anywhere you want to take it.

H.M.Jr: I want to get out of the realm of theory so I can show it to some other economists and let them take a look at it. When we get this stuff, I intend to show it to these other people - Viner and Hanson, etc. I am not going off half-cocked on this stuff. I haven't got anything to show to anybody.

Haas: I think the sooner, the better.

H.M.Jr: I haven't got anything.

Haas: You've got ....- Of course, I am not the one to build up .....

H.M.Jr: All right. Well, you two fellows stay behind.

John, would you take this as a suggestion on our tax forum. It may or may not be good. A fellow that used to do some accounting for me eight or ten years ago. (H.M.Jr. handed memo to Mr. Hanes.)

Herbert?

Gaston: I haven't anything this morning.

H.M.Jr: I think the second article of Fortune on Government bonds is going to be all right; it is all right.

(Nods to Mr. Gaston.)

Gaston: (Nods "Nothing.")

H.M.Jr: Well, the next thing is ten fifteen.

Oliphant: (Nods "Nothing.")

Taylor: Ten o'clock, you say?

H.M.Jr: Ten fifteen.

Taylor: I thought you said ten o'clock, Brazil.

H.M.Jr: That's Tuesday.

Taylor: Oh, Tuesday.



FOREIGN POLICY ASSOCIATION

Incorporated

NATIONAL HEADQUARTERS: 8 WEST 40th STREET, NEW YORK

Telephone: CHickering 4-6390

Cable Address: Forpolas

196

RAYMOND LESLIE BUELL  
President

November 21, 1938

Honorable Henry Morgenthau  
Department of the Treasury  
Washington, D. C.

Dear Mr. Morgenthau:

In accordance with our conversation  
on Friday, I am glad to send you a copy of some  
private letters of Mr. Charles Thomson, a member  
of our staff in Latin America.

Sincerely yours,

Raymond L. Buell

RLB:RR  
encs.

Oliphant ✓  
Gaston ✓  
Hass ✓  
Taylor ✓  
Honey ✓  
Gibbons ✓  
Duffield ✓  
White ✓ 197  
Lockhead ✓  
Bell ✓  
McReynolds ✓

Note: One copy sent to each of the above as per H. S. K's instructions.

Nov. 29/38 MCH

November 22, 1958.

Dear Mr. Baell:

It was very good of you to send me the copies of the private letters from Mr. Charles Thomson, a member of your staff. I have been most interested in reading these and appreciate your sending them.

Sincerely,

Mr. Raymond L. Baell,  
President, Foreign Policy Association,  
8 West 40th Street,  
New York, New York.

GHF/abs

NEWS LETTER ON PARAGUAY  
 Charles A. Thomson  
 Foreign Policy Association

Buenos Aires  
 October 10, 1938

Confidential  
 Not for Publication.

Thanks to the kindness of Ambassador Spruille Braden, I have just witnessed the signing of the Chaco arbitral award, which definitely fixes the boundary between Bolivia and Paraguay. The ceremony was held under the white and gold magnificence of the "salón de honor" in the Argentine Foreign Office. Thus, the road to the long-sought peace is finally free of the last serious hurdle. In passing, I might say that informed opinion generally accords Spruille Braden major credit for the successful conclusion which has happily crowned three years of delicate and arduous negotiations.

During my recent visit to Paraguay, I found that country ready to welcome the Chaco peace. The overwhelmingly favorable majority in the plebiscite of August 10 surprised even the most experienced political observers. Geronimo Zubizarreta, the Liberal leader who had refused to sign the pact, found no support for his intransigent position. The voting in the plebiscite seems to have been essentially fair; it is reported that the government was prepared to use pressure to secure a favorable result, but found that such intervention would be superfluous. Opponents of the peace terms had criticized most the failure to give Paraguay any share in the alleged petroleum wealth along the western edge of the Chaco. Their chief complaint against the plebiscite was that its phrasing was loaded in favor of an affirmative vote. But they now appear willing to accept the popular decision, and declare that Paraguay will loyally abide by the peace terms and that no subsequent government will question their validity.

The war has made the army the dominant factor in the country. In the past, two major parties disputed control of Paraguay. At the end of the disastrous Five Year's War with Argentina, Brazil and Uruguay, a group of generals organized the Partido Nacional Republicano, known as the Colorados. This party ruled for 34 years, from 1870 to 1904. Meanwhile, civilian elements had formed the Liberal Party, and this group, although plagued at times by factional strife, dominated the political scene from 1904 to 1936. Foreign observers report that the Liberals are more blessed with able and intelligent leaders than their traditional opponents.

In February 1936 the Liberal president, Dr. Eusebio Ayala, who had served throughout the war, was overthrown by Colonel Rafael Franco. The Franco movement was backed by restive ex-service men - demobilized after fighting ended with the armistice of June 1935 - by labor unions and by some students. These elements considered the old parties discredited and sought a new political and economic alignment. Moreover, Ayala's position had been weakened, due to fears that he sought a second term,

-2-

and to the jealousy excited among military leaders by the special favors heaped on General Estigarribia. Franco's regime made some efforts at land distribution and put on the books several pieces of social legislation, including establishment of a National Department of Labor, with power to settle industrial disputes. But politically his administration was a hybrid. Juan Stefanich, the leading figure in the cabinet, was credited with semi-fascist ideas and a nationalism which would return Paraguay to the dictatorial traditions of its first half century as a nation. Labor and the students, on the other hand, had been influenced by communist and socialist ideas. Franco failed to get his dissident supporters to pull together, despite efforts to unite them in a new party. He also proved unable to hold the entire support of the army - whose war-time leader, General Estigarribia, he had imprisoned - or to enlist the backing of the more solid and conservative civilian leaders. His government was overturned in August 1937 by certain army officers, in alliance with the Liberal politicians.

A provisional regime, headed by Felix Paiva, a professor, was set up. But the civilians in the present government are described as substantially "messenger boys" for the army officers, who hold the actual reins of power. Four men particularly stand out: Colonel Ramon Paredes, a shrewd politician in uniform who occupies the ranking cabinet post of Minister of the Interior; Colonel Antola, commander-in-chief of the army; Major Arturo Bray, half-English in blood, who fought with Britain's forces during the World War, and who now is Chief of Police of Asuncion; and Major Sosa Valdes, commander of three cavalry regiments. All of these men are under 45 years of age. Their rule is in effect a military dictatorship, which justifies itself on the ground that Paraguay needs above all order and tranquillity. The press is closely censored, and offending newspapers suspended. Many of the most important opposition leaders are in exile. The relation of this reigning quartette to General Estigarribia is not entirely clear. Some observers believe that the "Four Horsemen" prefer to keep Estigarribia in his present post in Washington, fearing that if he returns to Paraguay, they will be eclipsed. Some sentiment exists in the country for establishment of a strong national government, with Estigarribia at the head. On the other hand, it is reported that Estigarribia himself would prefer not to take office during this transitional period.

Army leaders declare that Paraguay is fundamentally a democratic country, and that their rule is temporary. Congressional elections were held on September 25th. The Colorados withdrew from the contest on August 31, charging lack of guarantees and official pressure in favor of the liberals. In consequence, the Liberals had no opposition and captured all seats in both houses. Paraguay has a compulsory voting law, so the Colorados cast blank ballots at the polls, whose number was reported to approximate 30% of the total 125,000 votes cast. Despite this none too en-

couraging venture toward democratic "normalcy", hopes are expressed that the convening of congress will permit civilian influences gradually to reassert themselves, and that the process will be continued by presidential elections next March. On the other hand, some military leader may upset the apple-cart by another attempt at dictatorship. The army, which is believed to number around 15,000 men, still consumes from 60 to 80 percent of the government budget. The country's economic situation may decide the issue between democracy and dictatorship.

Paraguay came out of the Chaco conflict with increased economic strains; and this despite the fact that it fought the modern world's most economical war. Paraguay ended the struggle without any major increase in its foreign debt, which now stands at 600,000 pounds sterling - for a nation of less than 1,000,000 people. Bankers estimate that the internal debt does not exceed 13,000,000 gold pesos (or about \$9,000,000.). Service on the foreign debt was suspended during the conflict, but both interest and amortization payments have since been resumed. Food was not rationed; agricultural production was markedly increased. Paraguay now imposes no quotas on imports and only partial exchange control. Government salaries are paid up to date. During the struggle the common soldier was paid at the rate of one Paraguayan peso a day, and the total per diem cost per man, including supplies and food as well as pay, did not exceed, according to the Minister of War, nine Paraguayan pesos. (The Paraguayan peso is now quoted at 70 to the Argentine peso, or approximately 280 to the dollar.)

How did Paraguay carry on its war-time financing. In addition to using its small gold reserve, it requisitioned the great bulk of foreign exchange accruing from exports, paying exporters its equivalent in paper pesos. With this exchange it purchased what supplies were imported. The paper pesos were of course the product of the printing press, and the result was serious inflation, the peso declining from 19 to the Argentine peso to a ratio of 90, before recovering to the present ratio of 70. Moreover, the Government requisitioned annually from cattle-growers some seven or eight percent of their herds, paying them in script, which subsequently has been exchanged for gold peso bonds, and was included in the figure for the internal debt just mentioned. Local banks and business houses also made relatively small loans, which in great part are reported to have been repaid.

Outside purchases of military supplies were cut to a minimum. Paraguayan leaders declare that the country started the war with an army of 3,000 men, of whom only 1,000 were in the Chaco. (Some informed sources, however, raise the 3,000 figure to 8,000.) It had at the finish 80,000 to 100,000 men, but never any more than 25,000 in the front line. Officials state that foreign purchases were principally rifle and machine-gun ammunition, some artillery ammunition, and a few planes, with ten the maximum number in active service at any one time. They assert that Paraguay imported no

artillery, no hand-grenades, no airplane bombs. Supplies of the last two items were supplied by a domestic war industry. The hand-grenade became a very important weapon, the soldier often preferring it to the rifle; production started at the rate of 30 a day and finished at the rate of 130 an hour. Truck bodies at the start were turned out at the rate of one every seven days; at the end seven per hour. But the Paraguayans assert that their best source of supplies was Bolivia, and that at the end of the war 80 percent of their armament had been captured from the enemy, including 40,000 rifles. They started the war with 44 pieces of artillery and finished with 66; yet, General Estigarribia told me that for months at a time the artillery was silent for lack of ammunition.

Paraguayan leaders are also united in denying that they received any large-scale aid from Argentina. They assert that the Buenos Aires government facilitated them no loan (although there were some short-terms transactions with Argentine banks), or supplied them with any munitions. However, when the League embargo was on, Argentine officials are reported to have shut their eyes to transit of European shipments up the Paraná River. The Paraguayan army included a so-called Argentine regiment, but this was recruited in the Argentine province of Formosa, which is largely populated by Paraguayans. An Argentine military mission was stationed at Asuncion when the war broke out, but this was promptly withdrawn. The Paraguayan army had the help of a few foreign officers, including a number of White Russians, but only a handful of Argentines. These Paraguayan denials, however, have not served to convince some foreign observers of the entire absence of Argentine assistance. Proof of this cooperation is lacking, but suspicion lingers. I pass these facts and figures on to you, for what they are worth in our present state of knowledge.

It is largely true that Paraguay is a country of no statistics and few definite facts. What you learn is always approximate, más o menos, more or less. Written sources are few, and verbal statements need to be checked and re-checked. For example, take the rise in the cost of living which the Chaco war and inflation have brought to Paraguay. A leading lawyer told me that since 1932 it had gone up three times, reporting that he had to send his servant to market with 600 Paraguayan pesos now instead of 200. Then I came upon the manager of a foreign bank wrestling in his office with a sheet of prices; the salary of his Paraguayan employees shifts with the price level. He ventured with some caution that the cost of living had gone up between 300 and 400 percent. Then I talked with a group at the National Confederation of Labor who asserted that the rise was 600 percent. I put it down as a Paraguayan fact that the increase had been at least three-fold.

-5-

But wages have lagged behind, and consequently there is some ground for discontent. The common laborer in town makes about 150 Paraguayan pesos a day, in the country about 100 (respectively 50 and 35 cents in U.S. currency). Wage figures furnished by labor leaders indicate a general rise of from 200 to 250 percent from 1932 to the present. The labor movement claims some 25,000 members. The strongest unions are found among the port workers and in building construction, packing houses, textile and shoe factories, and on the railroads and street-cars. In 1931 the labor unions were dissolved by the Guggiari government, but with the accession of Colonel Franco in 1936, they came out again into the open; the National Confederation of Labor was formed, and some gains were made. Leaders now advocate a moderate policy and "democratic" tendencies, and play down socialist and communist ideas, which in the past had won some ground.

Nonetheless, the danger of "communism" is cited by the military as justification for the present dictatorial government. It serves equally well those Paraguayans - chiefly army officers and war veterans - who think of themselves as fascist, and who organized the "Frente de Guerra". One colonel told me, "The officers are fascist principally because they are opposed to communism, which is the worst type of dictatorship; and in the past communist ideas have been strong among the masses." The "Frente de Guerra" has attacked both old parties, criticizes "sloppy" democracy, and argues for nationalism and dictatorship. Opinions differ widely as to how much real influence it has. Aside from the "Frente," it does not appear that Nazi and fascist influences have made much dent. Some of the newspapers carry Italian and German propaganda; both nationalities run schools in Asuncion, but chiefly for their own children, rather than the Paraguayans. The Franco government ordered 36 airplanes from Italy - Caproni bombers and Fiat fighters. The first shipment recently reached Asuncion, but has been held in the customs until Paraguay was ready to make payment. But now that the Chaco war is over, the government does not need the planes, and is reported to be shopping around to find a customer for these unwanted goods.

The most interesting foreign influence in Paraguay is that of Argentina. There is no doubt that this "backwoods" republic, which has been frontier country for three centuries, falls within Argentina's economic empire. But this is not due primarily to heavy investments of Buenos Aires capital. Argentines are the largest landholders in the Chaco, but at that the worth of their vast tracts probably does not exceed \$5,000,000. Argentine capital is also reported in the railroads, and in the streetcars of the capital. It also controls the Mihanovitch line, owning the most important steamer fleet which links Asuncion with Buenos Aires. And it is through control of communications that Argentina has what some Paraguayans feel is a strangle-hold on their economic



life. For most of Paraguay's foreign trade goes down the river, the greater part of it on Mihanovitch boats, and much of it is transshipped at Buenos Aires. If Argentina closes its ports, as happened a year ago when yellow fever was reported in Paraguay, this inland republic is cut off from the world. Hence, the authorities at Asuncion are playing with the idea of an outlet through Brazil, either by a road via Iguassú to open up to tourist traffic the famous falls there; or by extending the Concepcion-Horqueta railroad line to the northeast to meet a similar projected line on the Brazilian side. But appealing as these projects look on the map, their economic utility is highly dubious. I must, however, say a word for the Iguassú Falls, which the guidebook reports are higher than Niagara and half again as wide. I flew over them on my way from Sao Paulo to Asuncion, and they are worth going a long way to see.

In addition to military dominance and some economic dislocation, the war has bequeathed Paraguay a new outlook on the future. Captain Bozzano, Minister of War and graduate of M.I.T. at Boston said to me: "Now a shadow of thirty years has been lifted. In the past we have had our thoughts centered on a war which we knew we would have to fight sometime. But now we can look ahead to constructive endeavors." A professor reviewing the results of the war declared: "It changed our national morale from that of a defeated nation which believed it could do nothing - the heritage of the Five Years War - to that of a victorious people with growing assurance and self-confidence." Paraguay is talking of reconstruction. It recognizes it has to start almost from scratch. In a conversation with ex-President Ayala here in Buenos Aires, he told me that a 1935 survey of Paraguay's 130,000 farmers revealed that they possessed only 5,000 steel plows. The seed commonly used is old and run down. New seed, new implements would multiply production and economic wealth. Given peace and the help of a little foreign capital, Paraguay's leaders hope that they face toward a future of growth and promise.

NEWS LETTER ON BRAZIL  
FROM Charles A. Thomson  
Foreign Policy Association

Buenos Aires,  
September 28, 1938

Confidential  
Not for publication.

On the night before I ended my month's stay in Brazil, I met with a group of some twenty university professors, industrialists, writers and economists. One of the questions we discussed referred to Brazil's foreign policy, in the case of a European war. "Brazil will never fight on the side of Germany," declared one member of the group, and his statement found unanimous support. The talk brought out - what is always so striking to anyone who has known the hostility to Yankee imperialism in many Spanish-American countries - Brazil's strong tradition of close friendship with the United States. These Brazilians hoped that the American states could keep out of a European war, but, some what may, they held that the nations of the New World should adopt and follow a common policy.

While realists tend to view President Vargas as a political opportunist par excellence, no Brazilians I talked with seriously believed that Vargas would - no matter what flirtations he may have considered in the past - attempt to carry Brazil away from its century-old alignment with the United States. In the field of trade Brazil has been willing to talk business with all customers. In the new rearmament program (to which I want to refer later), Germany won the right to provide the bulk of supplies for the army. But geography, historical tradition and economics are to be counted in the balance on the side of the United States.

Moreover, internal factors influence Brazil's attitude toward Germany. Brazilians have followed the negotiations on the Sudeten question with close attention. The arguments advanced for a plebiscite and for the minority rights of German residents in Czechoslovakia could theoretically be urged also in favor of the German colonies in Brazil. One journalist in a recent article opposed the principle of plebiscites, suggesting that if one were held in Brazil, the Germans and their sympathizers might win a majority in the three southern states of Paraná, Santa Catharina and Rio Grande do Sul. While this is an exaggerated statement, informed observers do not minimize the threat of German penetration. They believe that the Nazis have been disposed to go just as far as they were permitted by counter forces.

Representatives of one Brazilian party told me that within the last six months they had been approached by certain Germans high in the business world, who asked what their attitude would be should the State of Rio Grande do Sul separate from Brazil to become a German colony or protectorate. The Germans offered this party, in return for a pledge not to oppose such a move, war materials, troops and other assistance to enable them to overturn the Vargas government and take power in Rio. It was intimated that Italy would support the German move. But the baited hook failed to bring a nibble.

There is great need for a thorough study - it would take six months or a year - on the number and activities of Germans,

-2-

Italians and Japanese in Brazil. Accurate facts are disappointingly scarce. The last national census was taken in 1920, and the next one is not due until 1940. Immigration statistics are an unsafe guide, for no one knows to what degree their totals have been modified by emigration, deaths and other factors. The most recent government estimates place the number of Italians in the country at 770,000; of Japanese at 134,000; and of Germans at 73,000. This latter figure seems incredibly low, since São Paulo State alone estimates its German population at 27,000; and the colonies resident in the other southern states of Paraná, Santa Catharina and Rio Grande do Sul are larger in all probability. But the Germans in Brazil have been significant not alone for their number, but also for their close-knit organization, and their aggressive zeal within recent years for spreading Nazi doctrines and influence. This crusade finally became an open threat to Brazilian unity; and the Vargas régime took steps to scotch the danger. On April 19 last a decree barred foreigners and foreign organizations from engaging in any political activity in Brazil, and also forbade propaganda favoring political parties in the immigrants' home lands. This measure was supplemented by laws in the States of Santa Catharina and Rio Grande do Sul, requiring that teachers in German and other foreign schools be Brazilians and classes be conducted in Portuguese. Such was German resentment at these measures that the Nazi "cultural attaché" in the Rio embassy, who was reported to have made even the German Ambassador play second fiddle - the attaché was a Nazi, while the Ambassador was not - left for Berlin by special plane. It is not yet clear to what degree this political set-back will affect the German trade drive. For the first four months of 1938, Germany retained the lead over the United States in Brazilian imports it had won in 1936 and 1937.

At the same time President Vargas has eliminated from the political scene Brazil's domestic fascists, the Integralists. When on November 10, 1937 he made himself absolute dictator of Brazil, scrapped the 1934 constitution and proclaimed a more authoritarian document, he had the active support of this strong, nation-wide party. The Integralists were led to expect they would play a prominent role in the new set-up, with one or more cabinet positions. (Leaders of other Brazilian parties, experienced in the ways of local politics, firmly believe the Integralists were receiving financial aid from Germany and Italy; they were spending far more money than could reasonably be secured from sources in Brazil). But once Vargas had consolidated his position, the Integralists were thrown into the discard and their party dissolved. After the abortive coup of last May, many of their members were jailed. The party is now underground; some observers believe it effectively crushed and its principal leaders discredited; other recall that it included numerous army and navy officers among its supporters and hold that it still retains sufficient force for a come-back should a favorable opportunity arise.

Thus President Vargas has taken action against both foreign and domestic fascists, and has made clear that his rule is dictatorship, Brazilian style. If you don't mind, I should like to put in here a few words as to how Brazil, with its Portuguese tradition, language and culture differs from Spanish-American countries. For Vargas is only to be understood in connection with his milieu. One of the lessons which a visit to Brazil teaches is that Brazilian conditions must necessarily be defined in Brazilian terms.

The Brazilian largely lacks the Spanish sense of personal dignity; he cares little for "front" or ceremony. He is informal, casual. At times he is unbelievably casual. Witness the Integralist attack on the Presidential Palace on May 11. The rebels did not trouble to post guards at the gates of the palace grounds; people drove in and out to see the fighting which was going on only twenty-five yards away. The Brazilian is tolerant, not fanatical. He makes no fetish of abstract principle. He lacks the cruelty of the Spaniard. He does not like to kill. The leader of the May revolt was not shot, but given only a ten-year sentence. The Brazilian has a genius for compromise; he does not recognize sharp lines of division; he does not make permanent enemies. Brazil does not have a color line, but rather a color zone - though the transition from white to black ranges by almost imperceptible stages. The same characteristic may be applied to social and political alignments. Brazil lacks a clear-cut Left and a clear-cut Right. The men who today are Vargas' enemies may be in his cabinet tomorrow. It is largely true that because President Vargas corresponds to this medium - and also to a certain transitional stage in Brazil's political development - he has been successful in holding power.

His government is of course a dictatorship. Talk of the plebiscite which was to ratify the November 1937 constitution is seldom heard. President Vargas and his associates are reported to feel they need not trouble with it. They apparently find it more convenient to govern directly by decree, than bother with a legislature. Interventors or federal commissioners, named by Vargas to replace former governors, rule all states except one. Civil liberties are at the whim of the authorities. Censorship muzzles the press; there is no freedom of speech. One American remarked: "I never attempt to discuss politics, except in small groups at private houses; I don't write about it in letters, for you never know when they will be opened." Arrests are arbitrary. Just before I left Sao Paulo, some twenty of the most important leaders in the Salles de Oliveira party were seized at the order of the Interventor, and told they could choose between imprisonment and exile from the city of São Paulo. I talked to men who had been imprisoned on suspicion for long periods. They left no doubt in my mind as to the fact of extensive police brutality. It was not "respectable" politicians who suffered, but alleged communists and to a lesser degree Integralists arrested after the attempted coup of last May.

The Vargas regime rests primarily on the support of the army and navy. It is a military dictatorship; but it is more than that, for it commands considerable popular support, due to Vargas' virtuosity at political juggling and conciliation, and to his courting of the masses through social legislation and other means. The president's supreme political astuteness is accorded universal recognition. Vargas does not talk; no one apparently knows what is in his mind, or what he will do next. He does not hold grudges; if he needs a man, he will use him, no matter if that man has fought against him in the past; but the discard awaits any man or party whose usefulness is ended. The president balances the power of one political leader with another, one state with a second, one general with his rival. A foreign observer remarked: "Vargas has been double-crossing the generals so fast, that he has them all dizzy; no one of them knows how long he can stay on his horse." The president is careful to see

that no member of his administration achieves too great power or position. Francisco Campos, Minister of the Interior and author of the 1937 constitution, has seen his personal star wax and wane. His reported admiration for fascist ideals is balanced by the democratic sentiments of Dr. Oswaldo Aranha, Foreign Minister, former Ambassador at Washington and friend of the United States. In the army, General Goes Monteiro, Chief of Staff, is played off against General Dutra, Minister of War. These two men, formerly friendly, are now reported to be at odds. Goes Monteiro is considered the more able and intelligent of the two, and is rated Brazil's best strategist; he was the star pupil of General Gamelin, when the latter - now France's Chief of Staff - was head of the French military mission in Brazil. Gossip has it that Aranha and Goes Monteiro favor holding the constitutional plebiscite and a gradual return to democratic norms, while Dutra opposes the plebiscite, and is suspected by some of ambitions to set himself up as the head of a neo-fascist régime. Talk of Vargas' possible overthrow turns most frequently on the Dutra-Goes Monteiro rivalry and friction.

President Vargas announced with his November 1937 coup the establishment of a New State in Brazil. Democracy had failed; Brazil henceforth was to have an authoritarian régime, which would unify the country in the face of a chaotic international situation, suppress subversive influences, and put new efficiency and drive into government. But what in practice, as distinguished from theory, does the New State stand for?

1. Direct government, that is, personal dictatorship. Vargas has ruled Brazil since the revolution of 1930, but there is some truth in the contention that events have limited his opportunities for constructive achievement. Between 1930 and 1934, attention necessarily centered first on consolidation of the new régime, then its defense against the 1932 Paulista revolt, and finally on the drafting of the 1934 constitution. The first Congress under this constitution was characterized by one foreign resident as "worse than a Ladies Aid Society"; talk blocked action. But with Congress out of the way after November 1937, governmental machinery began to hum. Office-holders were forbidden to hold more than one job; and the efficiency of the bureaucracy was stepped up. Some of the worst grafters were eliminated. (In this connection Vargas is generally credited with entire personal honesty.) The president and his advisers turned out decrees much more swiftly than Congress had produced laws. Since November 1937 it is stated that 500 laws and 3000 decrees have been issued. But much of this legislation is hastily and carelessly drafted. Formerly debate in Congress served to iron out defects, but now that chance is lost.
2. Centralized government, as opposed to the former emphasis on state's rights, which in Brazil has been carried farther than in the United States. To use a word coined by Foreign Minister Aranha in an interview, the tendency was to "Chinify" Brazil. In several cases the state militias were armies in all but name; and some were equipped with tanks and bombing planes. Brazil's only anti-aircraft guns were ordered by Governor Flores da Cunha for the state forces of Rio Grande do Sul, but arrived after he had been ousted. States had the power to levy export duties. Now President Vargas has reduced the

power of the militias, particularly in those states where they might be used against him; and also decreed progressive elimination of the state export duties. Opposition to this trend toward centralization is strongest in São Paulo, Brazil's richest and most productive state, which seeks as far as possible to run its own affairs.

3. Nationalism. I have already mentioned the legislation against foreign organizations, and the quietus put on German activities. In addition the November 1937 constitution required the shareholders of banks and insurance companies to be Brazilians (a provision not yet enforced) and pointed toward the progressive nationalization of mines and waterpower. Last April a decree excluded foreign interests from the petroleum industry, just at the time when a large refinery of Standard Oil of New Jersey was about to begin operations,

4. Rearmament. Along with the nationalistic emphasis has gone a program to strengthen the armed forces. This had been under discussion for years, but the November coup freed Vargas' hands for immediate action. Brazil plans to spend some \$100,000,000 on this program during the next five years. According to an agreement concluded before the President fell out with the Nazis, Germany is to provide the bulk of material for the army - heavy artillery, light artillery, anti-aircraft guns, etc. Brazil is scheduled to receive from Germany each year for the next five years 50,000,000 marks worth of supplies, or a total of 250,000,000 marks. Of this sum, approximately five-sixths can be paid in compensated marks, and the balance in free exchange. (Thus in spite of Washington's efforts to discourage Brazil's experiments in barter trade, the country - barring a European war - is committed by this arms agreement to compensated marks for at least five years. A high military authority told me he considered the dependence of Brazil's army on German supplies a great mistake; should a European conflict break, Brazil would be cut off from Germany, would have to turn to the United States for munitions, and would be handicapped by a confusing variety of models in its armament.) For the navy three submarines were bought from Italy, and negotiations are reported under way for three more. Three cruisers were ordered from England, and three others are to be built in Brazil, using fabricated material from the United States. In this way Brazil plans to secure the cruisers which it originally proposed to lease from the United States.

Some observers view Brazil's failure to obtain those cruisers as a crucial event profoundly influencing the recent trend toward dictatorship. According to this theory, the success of Argentina in blocking the proposed deal spread consternation among Brazilian leaders. Brazil had believed it enjoyed a favored position in American friendship. But Argentina, its most feared rival, had been able to ruin its prospects. President Vargas is reported to have called together army and navy chiefs and pledged them his support in building up Brazil's armed strength against this threatening development. Thus was born the alliance which made possible the November 1937 coup. For only Vargas could give the military leaders the money they wanted. Both of the leading candidates in the presidential campaign of that year had obligations to various interests and supporters; neither would be strong enough to take the step which alone could make possible the enlarged expenditures for the armament program - suspension of service on the foreign debt. So the elections were called off, and Vargas with the backing of the army and navy made himself absolute dictator. Now the armed forces are getting what they want, and resumption of service on the foreign debt is a dead issue.

-8-

5. A "mixed" economic policy. While the 1937 constitution pointed Brazil toward the "corporative organization of national economy," the most important recent shift in policy - that relating to coffee exports in the fall of 1937 - was away from regimentation and in the direction of liberalism and free trade. The government abandoned price defense, and the coffee export tax was reduced from 45 to 12 milreis a bag. But in May of this year over-production again threatened, and a decree required each grower to turn over to the government a "sacrifice quota" of 30% of his production (15% in the case of the finer coffees). However, coffee experts with whom I talked believe that Brazil is approaching an equilibrium between production and market demand. In the state of São Paulo alone between 300,000,000 and 400,000,000 trees have been cut down; the coffee borer has reduced output; there seems to be growing recognition that future emphasis must be on improvement of quality rather than increase of quantity. Hopes are expressed that the quota provision may be removed early in 1939, and future reestablishment of control avoided.

The fall in the world price of coffee has been compensated in the case of Brazil by a quantitative increase in exports. Nonetheless Brazil has suffered a recent recession; internal trade is estimated at about 25% below last year, but the decline has been less severe than in the United States.

The Brazilian government railroads have under consideration purchase of 26 locomotives and 1000 freight cars, worth some \$6,000,000. The Germans are after the order, and are reported to have offered four-year credits, but are unable to promise prompt delivery. Americans in Brazil, in view of the country's great need for improved and more extensive communications, argue that it is of strategic importance for the United States to secure this order. At the time of my stay, decision promised to hinge on the ability of the Export-Import Bank to offer credit terms which might compete with those of the Germans.

6. Social legislation. The Vargas regime since 1930 has been responsible for a large mass of social legislation, including the 8-hour day, one day's rest in seven, special protection for women and children, and now a minimum-wage law which is soon to go into effect. While labor supporters deny that this legislation has been very effective, employers report that it is enforced to an uncomfortable degree. Labor organization is under government control. Unions are organized by the government, protected by the government and subordinate to the government. Strikes are forbidden. In São Paulo city the cost of living index rose from 100 in 1934 to 161 in 1938, the chief increases being in food items; but in other parts of Brazil, particularly the rural districts, the rise was less marked. Studies made in São Paulo estimate 10 milreis (about fifty cents in U. S. currency) to be the minimum living wage, to provide bare necessities for a family of five; but the great bulk of the wage-earners are reported to receive less than this minimum figure.

7. President Vargas has yet to show achievement in a field where a dictator usually makes his greatest claims - that of public works. One of the most frequently repeated charges made against him is that he is not a builder. Brazilian cities, such as Rio de Janeiro, São

São Paulo and Belo Horizonte, have been going through a construction boom, and many new government edifices have been erected. But Brazil has almost no paved roads, outside of a ten-mile stretch south of the city of São Paulo, and the section connecting the summer capital at Petropolis with Rio. Vargas has promised to initiate shortly paving of the road between Rio and São Paulo. Engineers also have under survey the route of a railroad across the northern edge of the Chaco to link the Brazilian city of Puerto Esperanza with Santa Cruz in Bolivia. But these developments are still substantially in the project stage.

Discussion is again under way on plans to exploit Brazil's vast ore deposits in Minas Geraes, much of which run 80% pure iron. The lack of good coal has handicapped development of heavy industry, but a number of blast furnaces and mills are now operating with charcoal and petroleum; this year Brazil exported some steel to Argentina. Optimism is expressed in certain circles at the possibilities of a new process for smelting at low temperatures. Some of Brazil's present leaders argue that if the country is to escape from a colonial status, where it exports raw materials and competes with low economic and social levels, it must industrialize, and should exhaust all efforts to that end.

How long can Vargas stay in power? No one in Brazil will answer this question, for no one knows. The President's wizardry at political juggling is an essential element in his success. But it also makes for almost a daily shift in guesses and for continuing uncertainty concerning the eventual trend of Brazilian politics. No one knows when Vargas' hand may slip and some one of the many balls in the air may escape his grasp. The most experienced observers take refuge in the assertion that practically anything can happen. There are some who believe that opposition to the present régime is gradually coalescing. Yet this opposition may lack opportunity to strike, unless Vargas suffers defection on the part of his military associates, or the economic curve takes an acute turn downward. Should he hold on indefinitely, the continuance of dictatorship or a gradual return to democratic processes is likely to be determined by the relative strength of the various domestic and international pressures which play on the "fox of Cattete."

I don't want to close without at least a brief reference to the matter of cultural relations. This is not the time for any detailed analysis or definite recommendations. But my whole visit to Brazil only served to underline the words of Foreign Minister Aranha that "it is terribly important for our two peoples to understand each other." It is substantially true that we in the United States know least about the country in South America which is most important to us.

Let me limit myself here to two or three items which bear on this subject. First, Brazilians reveal to a unique degree a widespread desire, a genuine eagerness for closer ties of understanding with the people of the United States. One American diplomatic officer remarked, "We official representatives usually have to work very hard to develop interest in our country; here we have that interest served to us on a silver platter." Yet many Brazilians feel that we have come to take their friendship for granted; and that we believe no particular effort is necessary to retain it. One writer



-8-

told me: "The United States has abandoned us; we are a nation of 40,000,000 people; we play an important role in South America; but you pay no attention to us. Italy and Germany are doing their best to win us for fascism. They furnish material to our newspapers; they have our journalists in their pay. They send us professors and lecturers. They give us radio broadcasts in Portuguese. But the United States is losing us. You need not copy fascist methods. But we need your active interest and support."

The situation in São Paulo University may serve as a case in point on the present situation. On its arts faculty are ten Italian professors and eight French. In addition to their Brazilian salary (which is low in comparison with foreign standards of living), their home salary is continued, their time in Brazil is considered double for a retirement allowance, and they are granted travelling expenses to return home once a year. The only American professor on the faculty is without any of these perquisites, which actually do not rank as luxuries, but serve to balance up the debit items involved in working abroad. His role is not that of propagandist - certainly not, in the narrow and derogatory sense of the word. He is trying to do a sound and scholarly job of teaching American history. In addition, his command of Portuguese has opened to him newspaper columns, which have given his interpretations of American life a wide audience. Yet he has no support from his home land. In a situation which is complex and unstable he stands alone.

I cite this particular instance only because it illustrates a definite problem, on which we have yet to make any effective attack.

NEWS LETTER ON BRAZIL  
FROM Charles A. Thomson  
Foreign Policy Association

Confidential  
Not for publication.

Buenos Aires,  
September 26, 1938

On the night before I ended my month's stay in Brazil, I met with a group of some twenty university professors, industrialists, writers and economists. One of the questions we discussed referred to Brazil's foreign policy, in the case of a European war. "Brazil will never fight on the side of Germany," declared one member of the group, and his statement found unanimous support. The talk brought out -- what is always so striking to anyone who has known the hostility to Yankee imperialism in many Spanish-American countries -- Brazil's strong tradition of close friendship with the United States. These Brazilians hoped that the American states could keep out of a European war, but, come what may, they held that the nations of the New World should adopt and follow a common policy.

While realists tend to view President Vargas as a political opportunist par excellence, no Brazilians I talked with seriously believed that Vargas would -- no matter what flirtations he may have considered in the past -- attempt to carry Brazil away from its century-old alignment with the United States. In the field of trade Brazil has been willing to talk business with all customers. In the new rearmament program (to which I want to refer later), Germany won the right to provide the bulk of supplies for the army. But geography, historical tradition and economics are to be counted in the balance on the side of the United States.

Moreover, internal factors influence Brazil's attitude toward Germany. Brazilians have followed the negotiations on the Sudeten Question with close attention. The arguments advanced for a plebiscite and for the minority rights of German residents in Czechoslovakia could theoretically be urged also in favor of the German colonies in Brazil. One journalist in a recent article opposed the principle of plebiscites, suggesting that if one were held in Brazil, the Germans and their sympathizers might win a majority in the three southern states of Parana, Santa Catharina and Rio Grande do Sul. While this is an exaggerated statement, informed observers do not minimize the threat of German penetration. They believe that the Nazis have been disposed to go just as far as they were permitted by counter forces.

Representatives of one Brazilian party told me that within the last six months they had been approached by certain Germans high in the business world, who asked what their attitude would be should the State of Rio Grande do Sul separate from Brazil to become a German colony or protectorate. The Germans offered this party, in return for a pledge not to oppose such a move, war materials, troops and other assistance to enable them to overturn the Vargas government

and take power in Rio. It was intimated that Italy would support the German move. But the baited hook failed to bring a nibble.

There is great need for a thorough study -- it would take six months or a year -- on the number and activities of Germans, Italians and Japanese in Brazil. Accurate facts are disappointingly scarce. The last national census was taken in 1930, and the next one is not due until 1940. Immigration statistics are an unsafe guide, for no one knows to what degree their totals have been modified by emigration, deaths and other factors. The most recent government estimates place the number of Italians in the country at 770,000; of Japanese at 134,000; and of Germans at 73,000. This latter figure seems incredibly low, since Sao Paulo State alone estimates its German population at 27,000; and the colonies resident in the other southern states of Parana, Santa Catharina and Rio Grande do Sul are larger in all probability. But the Germans in Brazil have been significant not alone for their number, but also for their close-knit organization, and their aggressive zeal within recent years for spreading Nazi doctrines and influence. This crusade finally became an open threat to Brazilian unity; and the Vargas regime took steps to scotch the danger. On April 19 last a decree barred foreigners and foreign organizations from engaging in any political activity in Brazil, and also forbade propaganda favoring political parties in the immigrants' home lands. This measure was supplemented by laws in the States of Santa Catharina and Rio Grande do Sul, requiring that teachers in German and other foreign schools be Brazilians and classes be conducted in Portuguese. Such was German resentment at these measures that the Nazi "cultural attache" in the Rio embassy, who was reported to have made even the German Ambassador play second fiddle -- the attache was a Nazi, while the Ambassador was not -- left for Berlin by special plane. It is not yet clear to what degree this political set-back will affect the German trade drive. For the first four months of 1938, Germany retained the lead over the United States in Brazilian imports it had won in 1936 and 1937.

At the same time President Vargas has eliminated from the political scene Brazil's domestic fascists, the Integralists. When on November 10, 1937 he made himself absolute dictator of Brazil, scrapped the 1934 constitution and proclaimed a more authoritarian document, he had the active support of this strong, nation-wide party. The Integralists were led to expect they would play a prominent role in the new set-up, with one or more cabinet positions. (Leaders of other Brazilian parties, experienced in the ways of local politics, firmly believe the Integralists were receiving financial aid from Germany and Italy; they were spending far more money than could reasonably be secured from sources in Brazil). But once Vargas had consolidated his position, the Integralists were thrown into the discard and

their party dissolved. After the abortive coup of last May, many of their members were jailed. The party is now underground; some observers believe it effectually crushed and its principal leaders discredited; others recall that it included numerous army and navy officers among its supporters and hold that it still retains sufficient force for a come-back should a favorable opportunity arise.

Thus President Vargas has taken action against both foreign and domestic fascists, and has made clear that his rule is dictatorship, Brazilian style. If you don't mind, I should like to put in here a few words as to how Brazil, with its Portuguese tradition, language and culture differs from Spanish-American countries. For Vargas is only to be understood in connection with his milieu. One of the lessons which a visit to Brazil teaches is that Brazilian conditions must necessarily be defined in Brazilian terms.

The Brazilian largely lacks the Spanish sense of personal dignity; he cares little for "front" or ceremony. He is informal, casual. At times he is unbelievably casual. Witness the Integralist attack on the Presidential Palace on May 11. The rebels did not trouble to post guards at the gates of the palace grounds; people drove in and out to see the fighting which was going on only twenty-five yards away. The Brazilian is tolerant, not fanatical. He makes no fetish of abstract principle. He lacks the cruelty of the Spaniard. He does not like to kill. The leader of the May revolt was not shot, but given only a ten-year sentence. The Brazilian has a genius for compromise; he does not recognize sharp lines of division; he does not make permanent enemies. Brazil does not have a color line, but rather a color zone -- though the transition from white to black ranges by almost imperceptible stages. The same characteristic may be applied to social and political alignments. Brazil lacks a clear-cut Left and a clear-cut Right. The men who today are Vargas' enemies may be in his cabinet tomorrow. It is largely true that because President Vargas corresponds to this medium -- and also to a certain transitional stage in Brazil's political development -- he has been successful in holding power.

His government is of course a dictatorship. Talk of the plebiscite which was to ratify the November 1937 constitution is seldom heard. President Vargas and his associates are reported to feel they need not trouble with it. They apparently find it more convenient to govern directly by decree, than bother with a legislature. Interventors or federal commissioners, named by Vargas to replace former governors, rule all states except one. Civil liberties are at the whim of the authorities. Censorship muzzles the press;

- 4 -

there is no freedom of speech. One American remarked: "I never attempt to discuss politics, except in small groups at private houses; I don't write about it in letters, for you never know when they will be opened." Arrests are arbitrary. Just before I left Sao Paulo, some twenty of the most important leaders in the Salles de Oliveira party were seized at the order of the Interventor, and told they could choose between imprisonment and exile from the city of Sao Paulo. I talked to men who had been imprisoned on suspicion for long periods. They left no doubt in my mind as to the fact of extensive police brutality. It was not "respectable" politicians who suffered, but alleged communists and to a lesser degree Integralists arrested after the attempted coup of last May.

The Vargas regime rests primarily on the support of the army and navy. It is a military dictatorship; but it is more than that, for it commands considerable popular support, due to Vargas' virtuosity at political juggling and conciliation, and to his courting of the masses through social legislation and other means. The president's supreme political astuteness is accorded universal recognition. Vargas does not talk; no one apparently knows what is in his mind, or what he will do next. He does not hold grudges; if he needs a man, he will use him, no matter if that man has fought against him in the past; but the discard awaits any man or party whose usefulness is ended. The president balances the power of one political leader with another, one state with a second, one general with his rival. A foreign observer remarked: "Vargas has been double-crossing the generals so fast, that he has them all dizzy; no one of them knows how long he can stay on his horse." The president is careful to see that no member of his administration achieves too great power or position. Francisco Campos, Minister of the Interior and author of the 1937 constitution, has seen his personal star wax and wane. His reported admiration for fascist ideals is balanced by the democratic sentiments of Dr. Oswaldo Aranha, Foreign Minister, former Ambassador at Washington and friend of the United States. In the army, General Goes Monteiro, Chief of Staff, is played off against General Dutra, Minister of War. These two men, formerly friendly, are now reported to be at odds. Goes Monteiro is considered the more able and intelligent of the two, and is rated Brazil's best strategist; he was the star pupil of General Gamelin, when the latter -- now France's Chief of Staff -- was head of the French military mission in Brazil. Gossip has it that Aranha and Goes Monteiro favor holding the constitutional plebiscite and a gradual return to democratic norms, while Dutra opposes the plebiscite, and is suspected by some of ambitions to set himself up as the head of a neo-fascist regime. Talk of Vargas' possible overthrow turns most frequently on the Dutra-Goes Monteiro rivalry and friction.

- 5 -

President Vargas announced with his November 1937 coup the establishment of a New State in Brazil. Democracy had failed; Brazil henceforth was to have an authoritarian regime, which would unify the country in the face of a chaotic international situation, suppress subversive influences, and put new efficiency and drive into government. But what in practice, as distinguished from theory, does the New State stand for?

1. Direct government, that is, personal dictatorship. Vargas has ruled Brazil since the revolution of 1930, but there is some truth in the contention that events have limited his opportunities for constructive achievement. Between 1930 and 1934, attention necessarily centered first on consolidation of the new regime, then its defense against the 1932 Paulista revolt, and finally on the drafting of the 1934 constitution. The first Congress under this constitution was characterized by one foreign resident as "worse than a Ladies Aid Society"; talk blocked action. But with Congress out of the way after November 1937, governmental machinery began to hum. Officeholders were forbidden to hold more than one job; and the efficiency of the bureaucracy was stepped up. Some of the worst grafters were eliminated. (In this connection Vargas is generally credited with entire personal honesty.) The president and his advisers turned out decrees much more swiftly than Congress had produced laws. Since November 1937 it is stated that 500 laws and 3000 decrees have been issued. But much of this legislation is hastily and carelessly drafted. Formerly debate in Congress served to iron out defects, but now that chance is lost.

2. Centralized government, as opposed to the former emphasis on state's rights, which in Brazil has been carried farther than in the United States. To use a word coined by Foreign Minister Aranha in an interview, the tendency was to "Chinify" Brazil. In several cases the state militias were armies in all but name; and some were equipped with tanks and bombing planes. Brazil's only anti-aircraft guns were ordered by Governor Flores da Cunha for the state forces of Rio Grande do Sul, but arrived after he had been ousted. States had the power to levy export duties. Now President Vargas has reduced the power of the militias, particularly in those states where they might be used against him; and also decreed progressive elimination of the state export duties. Opposition to this trend toward centralization is strongest in Sao Paulo, Brazil's richest and most productive state, which seeks as far as possible to run its own affairs.

3. Nationalism. I have already mentioned the legislation against foreign organizations, and the quietus put on German activities. In addition the November 1937 constitution required the shareholders of

- 6 -

banks and insurance companies to be Brazilians (a provision not yet enforced) and pointed toward the progressive nationalization of mines and waterpower. Last April a decree excluded foreign interests from the petroleum industry, just at the time when a large refinery of Standard Oil of New Jersey was about to begin operations.

4. Rearmament. Along with the nationalistic emphasis has gone a program to strengthen the armed forces. This had been under discussion for years, but the November coup freed Vargas' hands for immediate action. Brazil plans to spend some \$100,000,000 on this program during the next five years. According to an agreement concluded before the President fell out with the Nazis, Germany is to provide the bulk of material for the army - heavy artillery, light artillery, anti-aircraft guns, etc. Brazil is scheduled to receive from Germany each year for the next five years 50,000,000 marks worth of supplies, or a total of 250,000,000 marks. Of this sum, approximately five-sixths can be paid in compensated marks, and the balance in free exchange. (Thus in spite of Washington's efforts to discourage Brazil's experiments in barter trade, the country -- barring a European war -- is committed by this arms agreement to compensated marks for at least five years. A high military authority told me he considered the dependence of Brazil's army on German supplies a great mistake; should a European conflict break, Brazil would be cut off from Germany, would have to turn to the United States for munitions, and would be handicapped by a confusing variety of models in its armament.) For the navy three submarines were bought from Italy, and negotiations are reported under way for three more. Three cruisers were ordered from England, and three others are to be built in Brazil, using fabricated material from the United States. In this way Brazil plans to secure the cruisers which it originally proposed to lease from the United States.

Some observers view Brazil's failure to obtain those cruisers as a crucial event profoundly influencing the recent trend toward dictatorship. According to this theory, the success of Argentina in blocking the proposed deal spread consternation among Brazilian leaders. Brazil had believed it enjoyed a favored position in American friendship. But Argentina, its most feared rival, had been able to ruin its prospects. President Vargas is reported to have called together army and navy chiefs and pledged them his support in building up Brazil's armed strength against this threatening development. Thus was born the alliance which made possible the November 1967 coup. For only Vargas could give the military leaders the money they wanted. Both of the leading candidates in the presidential campaign of that year had obligations to various interests and supporters; neither would be strong enough to take the step which alone could

- 7 -

make possible the enlarged expenditures for the armament program -- suspension of service on the foreign debt. So the elections were called off, and Vargas with the backing of the army and navy made himself absolute dictator. Now the armed forces are getting what they want, and resumption of service on the foreign debt is a dead issue.

5. A "mixed" economic policy. While the 1937 constitution pointed Brazil toward the "corporative organization of national economy," the most important recent shift in policy -- that relating to coffee exports in the fall of 1937 -- was away from regimentation and in the direction of liberalism and free trade. The government abandoned price defense, and the coffee export tax was reduced from 48 to 12 milreis a bag. But in May of this year over-production again threatened, and a decree required each grower to turn over to the government a "sacrifice quota" of 30% of his production (15% in the case of the finer coffees). However, coffee experts with whom I talked believe that Brazil is approaching an equilibrium between production and market demand. In the state of Sao Paulo alone between 300,000,000 and 400,000,000 trees have been cut down; the coffee borer has reduced output; there seems to be growing recognition that future emphasis must be on improvement of quality rather than increase of quantity. Hopes are expressed that the quota provision may be removed early in 1939, and future reestablishment of control avoided.

The fall in the world price of coffee has been compensated in the case of Brazil by a quantitative increase in exports. Nonetheless Brazil has suffered a recent recession; internal trade is estimated at about 25% below last year, but the decline has been less severe than in the United States.

The Brazilian government railroads have under consideration purchase of 26 locomotives and 1000 freight cars, worth some \$6,000,000. The Germans are after the order, and are reported to have offered four-year credits, but are unable to promise prompt delivery. Americans in Brazil, in view of the country's great need for improved and more extensive communications, argue that it is of strategic importance for the United States to secure this order. At the time of my stay, decision promised to hinge on the ability of the Export-Import Bank to offer credit terms which might compete with those of the Germans.

6. Social legislation. The Vargas regime since 1930 has been responsible for a large mass of social legislation, including the 8-hour day, one day's rest in seven, special protection for women and children, and now a minimum-wage law which is soon to go into effect.



While labor supporters deny that this legislation has been very effective, employers report that it is enforced to an uncomfortable degree. Labor organization is under government control. Unions are organized by the government, protected by the government and subordinate to the government. Strikes are forbidden. In Sao Paulo city the cost of living index rose from 100 in 1934 to 161 in 1938, the chief increases being in food items; but in other parts of Brazil, particularly the rural districts, the rise was less marked. Studies made in Sao Paulo estimate 10 mlreals (about fifty cents in U. S. currency) to be the minimum living wage, to provide bare necessities for a family of five; but the great bulk of the wage-earners are reported to receive less than this minimum figure.

7. President Vargas has yet to show achievement in a field where a dictator usually makes his greatest claims -- that of public works. One of the most frequently repeated charges made against him is that he is not a builder. Brazilian cities, such as Rio de Janeiro, Sao Paulo and Belo Horizonte, have been going through a construction boom, and many new government edifices have been erected. But Brazil has almost no paved roads, outside of a ten-mile stretch south of the city of Sao Paulo, and the section connecting the summer capital at Petropolis with Rio. Vargas has promised to initiate shortly paving of the road between Rio and Sao Paulo. Engineers also have under survey the route of a railroad across the northern edge of the Obaco to link the Brazilian city of Puerto Saferanda with Santa Cruz in Bolivia. But these developments are still substantially in the project stage.

Discussion is again under way on plans to exploit Brazil's vast ore deposits in Minas Geraes, much of which run 60% pure iron. The lack of good coal has handicapped development of heavy industry. But a number of blast furnaces and mills are now operating with charcoal and petroleum; this year Brazil exported some steel to Argentina. Optimism is expressed in certain circles at the possibilities of a new process for smelting at low temperatures. Some of Brazil's present leaders argue that if the country is to escape from a colonial status, where it exports raw materials and competes with plantation countries with low economic and social levels, it must industrialize, and should exhaust all efforts to that end.

How long can Vargas stay in power? No one in Brazil will answer this question, for no one knows. The President's wizardry at political juggling is an essential element in his success. But it also makes for almost a daily shift in guesses and for continuing uncertainty concerning the eventual trend of Brazilian politics. No one knows when Vargas' hand may slip and some one of the many balls in the air may escape his grasp. The most experienced observers

- 9 -

take refuge in the assertion that practically anything can happen. There are some who believe that opposition to the present regime is gradually coalescing. Yet this opposition may lack opportunity to strike, unless Vargas suffers defection on the part of his military associates, or the economic curve takes an acute turn downward. Should he hold on indefinitely, the continuance of dictatorship or a gradual return to democratic processes is likely to be determined by the relative strength of the various domestic and international pressures which play on the "fox of Cattete."

I don't want to close without at least a brief reference to the matter of cultural relations. This is not the time for any detailed analysis or definite recommendations. But my whole visit to Brazil only served to underline the words of Foreign Minister Aranha that "it is terribly important for our two peoples to understand each other." It is substantially true that we in the United States know least about the country in South America which is most important to us.

Let me limit myself here to two or three items which bear on this subject. First, Brazilians reveal to a unique degree a widespread desire, a genuine eagerness for closer ties of understanding with the people of the United States. One American diplomatic officer remarked, "We official representatives usually have to work very hard to develop interest in our country; here we have that interest served to us on a silver platter." Yet many Brazilians feel that we have come to take their friendship for granted; and that we believe no particular effort is necessary to retain it. One writer told me: "The United States has abandoned us; we are a nation of 40,000,000 people; we play an important role in South America; but you pay no attention to us. Italy and Germany are doing their best to win us for fascism. They furnish material to our newspapers; they have our journalists in their pay. They send us professors and lecturers. They give us radio broadcasts in Portuguese. But the United States is losing us. You need not copy fascist methods. But we need your active interest and support."

The situation in Sao Paulo University may serve as a case in point on the present situation. On its arts faculty are ten Italian professors and eight French. In addition to their Brazilian salary (which is low in comparison with foreign standards of living), their home salary is continued, their time in Brazil is considered double for a retirement allowance, and they are granted travelling expenses to return home once a year. The only American professor on the faculty is without any of these perquisites, which actually do not rank as luxuries, but serve to balance up the debit items involved

- 10 -

in working abroad. His role is not that of propagandist -- certainly not, in the narrow and derogatory sense of the word. He is trying to do a sound and scholarly job of teaching American history. In addition, his command of Portuguese has opened to him newspaper columns, which have given his interpretations of American life a wide audience. Yet he has no support from his home land. In a situation which is complex and unstable he stands alone.

I cite this particular instance only because it illustrates a definite problem, on which we have yet to make any effective attack.